179

P.V.

CLERK'S COPY.

402709
Sup. Ct.

TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1940

No. 5

HARRY H. NEUBERGER, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED NOVEMBER 21, 1939.

CERTIORARI GRANTED MAY 27, 1940.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1940

No. 5

HARRY H. NEUBERGER, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

INDEX.

	Page
Proceedings before United States Board of Tax Appeals	1
Docket entries	1
Amended petition	3
Notice of deficiency	7
Answer to amended petition	10
Stipulation of facts	12
Exhibit "A"—Petitioner's income tax return for calendar year 1932	15
Findings of fact and opinion, Arnold, M.	20
Decision	24
Petition for review (Harry H. Neuberger)	25
Praecipe for record	30
Clerk's certificate	31
Stipulation consolidating records	32
Petition for review (Commissioner of Internal Revenue)	34
Notice of filing petition for review	40
Notice of filing petition for review	41
Praecipe for record	43
Clerk's certificate	45
Proceedings in U. S. C. C. A., Second Circuit	46
Opinion, per curiam	46
Petition for reargument	48
Orders denying petition for rehearing	51
Judgment	53
Clerk's certificate	53
Order extending time within which to apply for writ of certiorari	54
Order allowing certiorari	55

JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., JUNE 27, 1940.
—8664

BLANK PAGE

Docket Entries.

Docket No. 78919. 1

HARRY H. NEUBERGER,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

APPEARANCES: 2

For Taxpayer: WALTER MENDELSOHN, ESQ., WILBER H. FRIEDMAN, ESQ.

For Comm'r: J. R. JOHNSTON, ESQ.

DOCKET ENTRIES.

1935

Mar. 28—Petition received and filed. Taxpayer notified. (Fee paid.)

" 28—Copy of petition served on General Counsel.

Apr. 26—Answer filed by General Counsel.

May 2—Copy of answer served on taxpayer.

Dec. 30—Hearing set Feb. 3, 1936. 3

1936

Jan. 10—Motion to transfer to the Reserve Calendar or to transfer to the New York Circuit Calendar filed by taxpayer. 1/13/36 granted and continued to May 4, 1936.

" 29—Notice of change of hearing to April 30, 1936.

Apr. 23—Motion to transfer to the Reserve Calendar or to transfer to the New York Circuit Calendar filed by taxpayer. 4/24/36 granted.

Dec. 17—Hearing set week of Feb. 15, 1937 at New York, N. Y.

Docket Entries.

4 1937

Feb. 15—Hearing had before Mr. Arnold. Submitted. Stipulation of facts and amended petition filed. Petitioner's brief due 3/31/37—respondent's 4/30/37—petitioner's reply 5/15/37.

Mar. 31—Brief filed by taxpayer. 3/31/37 copy served.

Apr. 17—Brief filed by General Counsel.

" 26—Reply brief filed by taxpayer. 4/26/37 copy served.

1938

Jan. 5—Motion for leave to file answer to amended petition, answer lodged, filed by General Counsel.

5 1/7/38 granted.

" 28—Findings of fact and opinion rendered, Mr. Arnold, Div. 12. Judgment will be entered under Rule 50.

Mar. 2—Computation of deficiency filed by General Counsel.

" 3—Hearing set March 23, 1938 on settlement.

" 5—Consent to settlement filed by taxpayer.

" 9—Order and decision entered, Wm. W. Arnold, Div. 12.

May 21—Petition for review by U. S. Circuit Court of Appeals (2) with assignments of error filed by General Counsel.

6

Jun. 6—Proof of service filed by General Counsel. Attorney and taxpayer.

" 7—Petition for review by U. S. Circuit Court of Appeals (2) with assignments of error filed by taxpayer.

" 8—Proof of service filed by taxpayer.

" 15—Praecipe filed by General Counsel with proof of service thereon.

Jul. 18—Praecipe of record filed by taxpayer with proof of service thereon.

Amended Petition.

7

UNITED STATES BOARD OF TAX APPEALS.

Docket No. 78919.

HARRY H. NEUBERGER,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

8

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his deficiency letter (IT:AR:A-2:AEF-90D), dated March 4, 1935, and as the basis of this proceeding, petitioner sets forth the following:

1. The petitioner is an individual, whose address is, c/o Proskauer, Rose & Paskus, 11 Broadway, New York.

2. The notice of deficiency, a copy of which is attached hereto, was mailed to petitioner on March 4, 1935.

3. The taxes in controversy are income taxes for the calendar year 1932 in the amount of $9,021.24. 9

4. Determination of the tax set forth in the notice of deficiency is based upon the following error:

(a) The Commissioner has erroneously disallowed as a deduction a loss of $27,096.88 on sales of securities held less than two years.

(b) In the alternative: The Commisisoner has erroneously disallowed as a deduction taxes and

10 commissions paid by petitioner in connection with the purchase and sale of securities during 1932 in the respective amounts of $2,779.69 and $5,220.56.

(c) In the alternative: The Commissioner has erroneously disallowed as a deduction a loss of $327 on a commodity transaction.

5. The facts upon which the petitioner relies as the basis of this petition, are as follows:

(a) During the year 1932, petitioner sold securities held less than two years at a net loss of $26,769.88, which he deducted on his return. Petitioner's transactions in such securities during 1932 were in such volume and amount as to constitute the carrying on of a business.

11

(b) During the year 1932, the taxpayer was a member of a partnership, which partnership during said year sold securities held less than two years at a profit, of which petitioner's distributive share was in excess of $26,769.88.

(c) Petitioner's share of the net income of said partnership, reported on petitioner's return for the year 1932, was in excess of the sum of $26,769.88.

12 (d) In connection with the purchase and sale of securities during the year 1932, petitioner paid taxes and commissions in the respective sums of $2,779.69 and $5,220.56. These taxes and commissions were not deducted on the return, but the taxes and commissions paid on securities sold during 1932 were deducted from the selling price reported on the return. The commissions in question were all paid to the firm of Hilson & Neuberger and were reported in its income tax return for the year 1932.

(e) In 1932, petitioner sold a grain futures contract held less than two years at a loss of $327. This sum has not been allowed as a deduction. 13

6. In the event that the Board holds that the Commissioner correctly interpreted Section 23 (r) of the Revenue Act of 1932 in this case, then claim is hereby made that said Section is unconstitutional, in that it deprives taxpayer of property without due process of law, and it is arbitrary, capricious and discriminatory, in violation of the Fifth Amendment to the Federal Constitution.

WHEREFORE, petitioner prays that this Board may hear the proceeding and grant him relief from the deficiency 14 asserted by the Commissioner, together with such other relief as to this Board may seem just and proper, upon the grounds above set forth.

Respectfully submitted,

WALTER MENDELSOHN,
WILBUR H. FRIEDMAN,
Counsel for Petitioner,
11 Broadway,
New York, N. Y.

Dated, New York, February 11, 1937. 15

Amended Petition.

State of New York,
County of New York—ss.:

HARRY H. NEUBERGER, being duly sworn, deposes and says: He is the petitioner above-named; that he has read the foregoing amended petition and is familiar with the statements contained therein, and that the facts stated are true, except as to those facts stated upon information and belief, and those facts he believes to be true.

HARRY H. NEUBERGER.

Sworn to before me this
11th day of February, 1937.

MARCIA C. MORSE,
Notary Public.
New York Co. Clerk's No. 258, Reg. No. 8-M-440.
My Commission expires March 30, 1938.
(Seal)

NOTICE OF DEFICIENCY, ANNEXED TO AMENDED PETITION.

19

IT:AR:A-2
AEF-90D

Mar. 4 1935

Mr. Harry H. Neuberger,
c/o Mr. Harry Goodkin,
116 John Street,
New York, New York.

Sir:

You are advised that the determination of your income tax liability for the year 1932, discloses a deficiency of $9,021.24 as shown in the statement attached.

In accordance with Section 272 (a) of the Revenue Act 20
of 1932, as amended by Section 501 of the Revenue Act of 1934, notice is hereby given of the deficiency mentioned. Within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency and will prevent the 21
accumulation of interest, since the interest period terminates thirty days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,
Commissioner.

By (Signed) CHAS. T. RUSSELL,
Deputy Commissioner.

Enclosures:

Statement
Form 870

Notice of Deficiency, Annexed to Amended Petition.

22 STATEMENT.

IT:AR:A-2
AEF-90D

In re: Mr. Harry H. Neuberger,
c/o Mr. Harry Goodkin,
116 John Street,
New York, New York.

Year 1932

23 Year	Income Tax Liability	Income Tax Assessed	Deficiency
1932	$9,566.80	$545.56	$9,021.24

Reference is made to the letter dated October 23, 1934, from your representative, Mr. Wilbur H. Friedman, 11 Broadway, New York, New York, in reply to office letter addressed to you under date of October 13, 1934, advising you that the report of the internal revenue agent in charge, 17 Battery Place, New York, New York, dated May 1, 1934, covering an investigation of your 1932 income tax liability had been approved in this office. This report indicated a deficiency in tax amounting to $9,021.24.

In accordance with the request contained in Mr. Friedman's letter, a conference was held in this office on December 5, 1934, at which time the question of disallowing the loss of $27,096.88, claimed on sales of stocks held less than two years was considered. The loss was disallowed by the Revenue agent in accordance with section 23(r) of the Revenue Act of 1932.

24

It is your contention that inasmuch as you reported on your return profit from sales of securities by the partnership of Hilson and Neuberger, the loss of $27,096.88 should be applied against such partnership income.

You are advised that this office holds that a taxpayer may not offset his personal losses from the sale of stocks

and bonds held less than two years by his share of similar gains of a partnership of which he is a member. Therefore, the action of the agent in disallowing the loss of $27,096.88 has been approved in this office. 25

Your net income and tax liability have therefore been adjusted as follows:

Ordinary net income as shown on return		$40,622.38
Add:		
1. Increase in partnership income		488.38
2. Loss disallowed		27,096.88
Ordinary net income as adjusted		$68,207.64
Capital net loss as shown on return		($28,152.69)
Ordinary net income as adjusted		$68,207.64
Less:		
Dividends	$22,593.93	
Personal exemption	3,300.00	25,893.93
Amount subject to normal tax		$42,313.71
Normal tax of 4% on $4,000.00		160.00
Normal tax of 8% on $38,313.71		3,065.10
Surtax on $68,207.64		9,886.44
Total		$13,111.54
Less: 12½% of capital net loss of $28,152.69	3,519.08	
Tax paid at source	25.66	3,544.74
Correct tax liability		$9,566.80
Tax previously assessed		545.56
Deficiency in tax		$9,021.24

26

27

28

Explanation of Changes

1. In accordance with information furnished by the revenue agent in his report dated May 1, 1934, covering an investigation of the partnership of Hilson and Neuberger, your share of the distributive income from this partnership has been increased by $488.38.

2. The loss of $27,096.88 claimed on sales of stocks held less than two years has been disallowed in accordance with section 23(r) of the Revenue Act of 1932, as explained above.

The adjustment of these items indicates a deficiency in tax amounting to $9,021.24 as explained above.

29

A copy of this communication has been forwarded to your representative, Mr. Wilbur H. Friedman, 11 Broadway, New York, New York, who has on file in this office a duly recorded power of attorney.

Answer to Amended Petition.

UNITED STATES BOARD OF TAX APPEALS.

Docket No. 78919.

30

HARRY H. NEUBERGER,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Comes now the respondent, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue and

for answer to the amended petition filed at the hearing of 31
the above-stated case, admits, denies and alleges as follows:

1. Admits the allegations in paragraph 1 of the amended petition.

2. Admits the allegations in paragraph 2 of the amended petition.

3. Admits the allegations in paragraph 3 of the amended petition.

4. Denies that error was committed in any respect as set forth in subparagraphs (a), (b) and (c) of the amended petition.

32

5 (a), (b), (c), (d) and (e). Admits only such facts alleged in the corresponding subparagraphs of paragraph 5 of the amended petition as are covered in the stipulation of facts and agreed to by the attorneys of the respective parties and filed at the hearing of the above proceeding. Denies all allegations of facts not covered in said stipulation of facts.

6. Denies the material allegations in paragraph 6 of the amended petition.

7. Denies generally and specifically each and every material allegation in the amended petition not herein admitted, qualified, or denied.

33

WHEREFORE, it is prayed that the Commissioner's determination be approved and that the taxpayer's appeal be denied.

J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:

J. R. JOHNSTON,
Special Attorney,
Bureau of Internal Revenue.

Stipulation of Facts.

34

UNITED STATES BOARD OF TAX APPEALS.

Docket #78919.

HARRY H. NEUBERGER,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

35

IT IS HEREBY STIPULATED between counsel for petitioner and counsel for respondent that the facts in the above case are as follows:

1. Petitioner is an individual and filed his income tax return for the calendar year 1932 in the Second District, New York. Said return is annexed hereto, marked Exhibit A, and is made a part hereof.

2. During said calendar year, petitioner traded in stocks and other securities in his individual capacity and incurred a net loss from sales or exchanges of stocks
36 and bonds which were not capital assets (as defined in Section 101 of the Revenue Act of 1932), in the sum of $25,588.93.

3. In computing said loss, stock transfer taxes and commissions on sales of securities were deducted from the selling price; commissions paid on purchase of securities were added to cost and treated as part of cost of securities sold. The Federal and New York stock transfer taxes on the sales amounted to $2,779.69.

Total commissions paid in 1932 in respect of shares bought and shares sold that year amounted to the sum of $4,440.61 of which $2,133.63 was commissions paid on the purchase of shares sold in 1932, and $2,306.98 was commissions paid on the sale of shares in 1932. Neither said taxes nor commissions were separately deducted on the return, although they were paid during the year 1932. The said commissions were paid to the firm of Hilson & Neuberger (referred to in paragraph "4" hereof), and were included by it as income in its income tax return, for the year 1932. 37

4. During the calendar year 1932, petitioner was a member of the partnership of Hilson & Neuberger, a Stock Exchange brokerage firm, 100 Broadway, New York, which also in said year traded in stocks and other securities. For the year 1932 said partnership derived a profit from the sale of stocks and other securities which were not capital assets as defined in Section 101 of the Revenue Act of 1932, in the amount of $142,802.29. The partnership had other income during 1932 (including commissions received), of $170,830.65, and deductions of $203,981.78, or a net income of $109,651.06. Petitioner's distributive share of said partnership profits amounted to $36,000 of the first $94,000 and 45% of the balance thereof. 38 39

5. During the calendar year 1932, petitioner incurred a loss of $327 upon the sale of a grain futures contract held less than two years. This loss was disallowed by the Commissioner in the determination of the deficiency here involved, but is now conceded as not being within the limitations set forth under Section 23(r) of the Revenue Act of 1932, and this loss may now be allowed on the Rule 50 computation.

40 6. Petitioner's distributive share of the partnership profits for 1932 was increased by the Commissioner by $488.38, which item is not in dispute.

7. During the year 1932, petitioner was a member of the New York Stock Exchange, and spent practically every working day of the year 1932 on the floor of the Exchange, trading for the account of his firm (Hilson & Neuberger), executing orders on behalf of customers of said firm, and trading for his individual account. While it is difficult for him to apportion his time to each of these activities, he gave considerable thought to the transactions for his individual account during
41 the year 1932. Reference is made to his 1932 return for a list of said transactions. He was constantly on the lookout for securities to buy or sell both for his individual account and for the account of his firm. He gave some thought to his individual transactions on practically every trading day, and the aggregate of time devoted to same during the year 1932 was very large.

8. The petitioner now claims the right to deduct from taxable income for the year 1932, the aforesaid loss of $25,588.93 from individual trading in stocks and other
42 securities, which deduction has been disallowed by the Commissioner; and in the alternative, the petitioner now claims the right to deduct the taxes and commissions referred to in paragraph "3" hereof.

WILBUR H. FRIEDMAN,
Counsel for Petitioner.

MORRISON SHAFROTH,
Counsel for Respondent.
J. R. J.

Dated, February 15, 1937.

Exhibit A, Annexed to Stipulation of Facts.

15

Form 1040
TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE

INDIVIDUAL INCOME TAX RETURN

FOR NET INCOMES FROM SALARIES OR WAGES OF MORE THAN $5,000 AND INCOMES FROM BUSINESS, PROFESSION, RENTS, OR SALE OF PROPERTY

For Calendar Year 1932

(Collector's Stamp) 27 ACKNOWLEDGMENT

Do Not Write in These Spaces

File No. 2115

Serial No. DEFERRED 7984

(Collector's Stamp) 6 MAR 13 COLLECTOR 2ND DIST. N.Y.

2-New York

Cash Check M.O. Cert. of Ind.

First Payment 545.56

Tax $ 902.1=4

Penalty

Interest

Total $

File This Return With the Collector of Internal Revenue for Your District on or Before March 15, 1933

PRINT NAME AND ADDRESS PLAINLY BELOW

HARRY H. KEUERGER (Name)

Bank CR or RAR 5-1-34

Audited by AET 3-4-1935

Unit No. AP-A-2

450 Beaver Street (Street and number, or rural route) C/o H.Hentz & Co.

New York City (Post office) (County) New York (State)

Occupation, Business, or Profession Member of New York Stock Exchange

1. Are you a citizen [illegible] United States? Yes
2. If you filed a return for 1931, to which Collector's office was it sent? Second Dist.N.Y.
3. Is this a joint return of husband and wife? Yes
4. State name of husband or wife if a separate return was made and the Collector's office to which it was sent
5. Were you married and living with husband or wife on the last day of your taxable year? Yes
6. If not, were you on the last day of your taxable year supporting in your household one or more persons [illegible]
7. How many dependent persons (other than husband or wife) under 18 years of age or incapable of self-support [illegible] support from you during your taxable year?
8. If your status in respect to question 5, 6, or 7 changed during the year, state date and [illegible]
9. State whether your books are kept on cash or accrual basis

U. S. BOARD OF TAX APPEALS
FILED
FEB 15 1937
EXHIBIT A-1

ATTACH REMITTANCE HERE

	INCOME	Amount received	Deductions paid (Explain in Schedule F)	
1.	Salaries, Wages, Commissions, Fees, etc. (State name and address of employer)	$	$	$
2.	Income from Business or Profession. (From Schedule A)			$ 907 44
3.	Interest on Bank Deposits, Notes, Corporation Bonds, etc. (except interest on tax-free covenant bonds)			1 983 33
4.	Interest on Tax-free Covenant Bonds Upon Which a Tax was Paid at Source			
5.	Income from Partnerships, Syndicates, Pools, etc. (State name and address) Hilson & Hemberger 100 Broadway Div.(10)1667. Profits			44 350 55
6.	Income from Fiduciaries. (State name and address)			
7.	Rents and Royalties. (From Schedule B)			27 098 88 X
8.	Profit from Sale of Real Estate, Stocks, Bonds, etc. (From Schedule C)			
9.	Taxable Interest on Liberty Bonds, etc. (From Schedule E) Div.(10) 1667 DIVIDEND NO. 5			22 593 93
10.	Dividends on: (a) Stock of Domestic Corporations subject to taxation under Title I of 1932 Act			
	(b) Stock of Domestic Corporations not subject to taxation under Title I of 1932 Act			108 38
	(c) Stock of Foreign Corporations			
11.	Other Income. (State nature of income) (a)			
	(b)			
12.	TOTAL INCOME IN ITEMS 1 TO 11			$ 50 287 37
	DEDUCTIONS			
13.	Interest Paid		$	
14.	Taxes Paid. (Explain in Schedule F)			600 38
15.	Losses by Fire, Storms, etc. (Explain in Table at foot of page 2)			
16.	Bad Debts. (Explain in Schedule F)			
17.	Contributions. (Explain in Schedule F)		3	469 34
18.	Other Deductions Not Reported Above. (Explain in Schedule F) Assuming Custodian etc		5	595 37
19.	TOTAL DEDUCTIONS IN ITEMS 13 TO 18			$ 9 664 99
20.	NET INCOME (Item 12 minus Item 19)			$ 40 622 38
21.	Less: Net loss for 1931 (Submit Schedule)			$
22.	NET INCOME FOR TAX COMPUTATION (Item 20 minus Item 21)			$ 40 622 38

RECEIVED MAR 15 1933 INTERNAL REVENUE

COMPUTATION OF TAX (See Instructions 22)

23.	Net Income Subject to Tax (Item 22 above)	$	$ 40 622 38	
24.	Less: Interest on Liberty Bonds, etc. (Item 9)	$		
25.	Dividends (Item 10 (a))	22,593 93		
26.	Personal Exemption	2,500 00		
27.	Credit for Dependents	800 00		
28.	Total of Items 24 to 27	$25,893 93	25 893 93	
29.	Balance subject to Normal Tax (Item 23 minus 28)		$ 14 728 45	
30.	Amount taxable at 4% (Not over $4,000)		$ 4 000 00	
31.	Amount taxable at 8% (Item 29 minus 30)		$ 10 728 45	
32.	Amount of Capital Net Gain or Loss (From Schedule D)		$ 28 152 69	
33.	Normal Tax (4% of Item 30)			$ 160 00
34.	Normal Tax (8% of Item 31)			858 28
35.	Surtax on Item 22 (See Instruction 23)			3 072 82
36.	Tax on Net Income (total of Items 33 to 35)			$ 4 090 30
37.	Ajustment for Capital Gain or Loss (12½% of Item 32)			3 518 08
38.	Total Tax (total of or difference between Items 36 and 37)			$ 572 22
39.	Less: Income Tax Paid at Source (3% of Item 6)	$ 25 56		
40.	Income Tax Paid to a foreign country or U. S. possession			26 66
41.	Balance of Tax (Item 38 minus 39 and 40)			$ 545 56

AFFIDAVIT

I swear (or affirm) that this return, including the accompanying schedules and statements, has been examined by me and is, to the best of my knowledge and

SCHEDULE A—INCOME FROM BUSINESS OR PROFESSION (See Instruction 2)

1. Total receipts from business or profession (state kind of business) ..... $

Cost of Goods Sold

2. Labor ..... $
3. Material and supplies .....
4. Merchandise bought for sale .....
5. Other costs (itemize below or on separate sheet) .....
6. Plus inventory at beginning of year .....
7. Total (Lines 2 to 6) ..... $
8. Less inventory at end of year .....
9. Net Cost of Goods Sold (Line 7 minus Line 8) ..... $

Enter "C," or "C or M," on Lines 6 and 8 to indicate whether inventories are valued at cost, or cost or market, whichever is lower.

Other Business Deductions

10. Salaries not included as "Labor" in Line 2. (Do not deduct compensation for your services) ..... $
11. Interest on business indebtedness to others .....
12. Taxes on business and business property .....
13. Losses (explain in table at foot of page) .....
14. Bad debts arising from sales or services .....
15. Depreciation, obsolescence, and depletion (explain in table provided at foot of page) .....
16. Rent, repairs, and other expenses (itemize below or on separate sheet) .....
17. Total (Lines 10 to 16) ..... $
18. Total Deductions (Line 9 plus Line 17) ..... $
19. Net Profit (Line 1 minus Line 18) (Enter as Item 2) ..... $

Explanation of deductions claimed on Lines 8 and 16 .....

SCHEDULE B—INCOME FROM RENTS AND ROYALTIES (See Instructions 7)

1. Kind of Property	2. Amount Received	3. Cost or Value (if acquired before March 1, 1913, whichever is greater)	4. Depreciation (Explain in table at foot of page)	5. Repairs	6. Other Expenses (Itemize below)	7. Net Profit (Enter as Item 7)
	$	$	$	$	$	$

Explanation of deductions claimed in Column 6 .....

SCHEDULE C—PROFIT FROM SALE OF REAL ESTATE, STOCKS, BONDS, ETC. (See Instruction 8)

1. Kind of Property	2. Date Acquired	3. Amount Realized	4. Cost	5. March 1, 1913, Value (if Acquired Prior to That Date)	6. Cost or Imputed Cost Subsequent to Acquisition or March 1, 1913	7. Depreciation Allowable (or Allowed) Since March 1, 1913	8. Net Profit or Loss (Enter as Item 8)
		$	$	$	$	$	$

Kind of property and location .....

SCHEDULE D—CAPITAL NET GAIN OR LOSS FROM SALE OR EXCHANGE OF CAPITAL ASSETS

5%	[illegible]	1930	70'085'20	0'643'12		
250k	[illegible]	7356\31	0'516'00	3'533'52		
750	[illegible]	-	0'110'00	23'200'82		
ch	[illegible]	1850	3'030'00	0'829'52	030'52	
430	[illegible]	7650\33	0'313'72	0'730'06		
305	[illegible]	1850\38	30'855'03	30'302'90	1'10[illegible]	

Kind of property and location .....

SCHEDULE E—INTEREST ON LIBERTY BONDS AND OTHER OBLIGATIONS OF SECURITIES (See Instruction 9)

	Personal Amount Free From Taxation	4. Amount Owned at Close of Taxable Year	5. Interest Received or Accrued During Taxable Year
[illegible] 0'000'00			
[illegible] 12'00		xxxxxx	xx
[illegible] 2'10		xxxxxx	xx
[illegible] 32'30		xxxxxx	xx
[illegible] 107'13			
(c) Liberty 3½ and 4¼% Bonds and Treasury Bonds		$5,000	
(d) Treasury Notes		All	xxxxxx xx

SCHEDULE F—EXPLANATION OF DEDUCTIONS CLAIMED IN ITEMS 5, 14, 16, 17, AND 18

EXPLANATION OF DEDUCTION FOR DEPRECIATION CLAIMED IN SCHEDULES A AND B

1. Kind of Property (If buildings, state material of which constructed)	2. Date Acquired	3. Life Years Assumed	4. Proportion Land Assumed	5. Cost (Exclusive of Land)	6. March 1, 1913, Value (if Acquired Prior to That Date) Exclusive of Land	7. Depreciation Allowable (or Allowed) Since March 1, 1913	8. Depreciation Allowable This Year
				$	$	$	$

EXPLANATION OF DEDUCTION FOR LOSSES BY FIRE, STORM, ETC., CLAIMED IN SCHEDULE A, AND IN ITEM 15

1. Kind of Property	2. Date Acquired	3. Cost or Value (if acquired before March 1, 1913, whichever is greater)	4. Depreciation Sustained	5. Depreciation Allowable Since Acquisition	6. Insurance and Salvage Value	7. Deductible Loss
		$	$	$	$	$

43

EXHIBIT A, ANNEXED TO STIPULATION OF FACTS. 44

Petitioner's Income Tax Return for Calendar Year 1932.

(PHOTOPRINTS.)

45

13	Interest Paid								
14	Taxes Paid. (Explain in Schedule F)				600	28			
15	Losses by Fire, Storm, etc. (Explain in Table at foot of page 2)								
16	Bad Debts. (Explain in Schedule F)								
17	Contributions. (Explain in Schedule F)		3	469	34				
18	Other Deductions Not Reported Above. (Explain in Schedule F) Insurance, Custodian etc		5	595	37				
19	TOTAL DEDUCTIONS IN ITEMS 13 TO 18					$	9	664	93
20	NET INCOME (Item 12 minus Item 19)					$	40	622	38
21	Less: Net loss for 1931 (Submit Schedule)					$			
22	NET INCOME FOR TAX COMPUTATION (Item 20 minus Item 21)					$	40	622	38

COMPUTATION OF TAX (See Instruction 23)

23	Net Income Subject to Tax (Item 22 above)		$	40	622	38			
24	Less: Interest on Liberty Bonds, etc. (Item 9)	$							
25	Dividends (Item 19 (a))	22,593	93						
26	Personal Exemption	2,500	00						
27	Credit for Dependents	800	00						
28	Total of Items 24 to 27	$25,893	93	25	893	93			
29	Balance subject to Normal Tax (Item 23 minus 28)		$	14	728	45			
30	Amount taxable at 4% (not over $4,000)		$	4	000	00			
31	Amount taxable at 8% (Item 29 minus 30)		$	10	728	45			
32	Amount of Capital Net Gain or Loss (From Schedule D)		$	2916	69				
33	Normal Tax (4% of Item 30)						$	160	00
34	Normal Tax (8% of Item 31)							858	28
35	Surtax on Item 22 (See Instruction 23)							3,072	92
36	Tax on Net Income (total of Items 33 to 35)						$	4,090	30
37	Adjustment for Capital Gain or Loss (12½% of Item 32)							583	32
38	Total Tax (total of or difference between Items 33 and 37)						$	572	22
39	Less: Income Tax Paid at Source (3% of Item 4)		$	25	66				
40	Income Tax Paid to a foreign country or U. S. possession							25	66
41	Balance of Tax (Item 38 minus 39 and 40)						$	543	56

AFFIDAVIT

I swear (or affirm) that this return, including the accompanying schedules and statements, has been examined by me, and to the best of my knowledge and belief is a true and complete return, made in good faith, for the taxable year stated, pursuant to the Revenue Act of 1932 and the Regulations issued thereunder.

(See Instruction 27)

Sworn to and subscribed before me this 13th day of March, 1933.

NOTARIAL SEAL

Margaret Paldini
(Signature of officer administering oath)

(Title)

If return is made by agent, the power thereto must be annexed to this form.

Larry L Hen Lung
(Signature of individual or agent)

(Address of agent)

An amended return must be marked "Amended" at top of return. Checks and drafts will be accepted only if payable at par.

SCHEDULE B—INTEREST ON LIBERTY BONDS AND OTHER OBLIGATIONS OF [illegible] CURITIES (See Instruction 9)

(a) Liberty 4% and 4½% Bonds and Treasury Bonds							35,000				
(c) Treasury Notes							AE				

SCHEDULE F—EXPLANATION OF DEDUCTIONS CLAIMED IN ITEMS 1, 14, 16, 17, AND 18

EXPLANATION OF DEDUCTION FOR DEPRECIATION CLAIMED IN SCHEDULES A AND B

(If buildings, state material of which constructed)	1. Kind of Property	2. Date Acquired	3. Cost or Other Basis	4. Depreciation Allowed (or Allowable) Prior to March 1, 1913	5. Depreciation Allowed (or Allowable) March 1, 1913, to Close of Preceding Year	6. Depreciation Allowable This Year
			$	$	$	$

EXPLANATION OF DEDUCTION FOR LOSSES BY FIRE, STORMS, ETC., CLAIMED IN SCHEDULE A, AND IN ITEM 15

1. Kind of Property	2. Date Acquired	3. Cost or Value as of March 1, 1913, if Acquired Before That Date	4. Depreciation Subsequent	5. Depreciation Allowable Prior to Loss	6. Insurance and Salvage Value	7. Deductible Loss
		$	$	$	$	$

46

47 EXHIBIT A, ANNEXED TO STIPULATION OF FACTS

(Continued).

(PHOTOPRINTS.)

[For the Convenience of Court and Counsel this Exhibit (Photostatic Copies) is bound in on the Opposite Page.]

48

Exhibit A, Annexed to Stipulation of Facts (Cont'd).

17

State how property was acquired .....

SCHEDULE E—INTEREST ON LIBERTY BONDS AND OTHER OBLIGATIONS OR SECURITIES (See Instruction 9)

	3. Principal Amount Exempt From Taxation	4. Amount Owned in Excess of Exemption	5. Interest on Amount in Excess of Exemption (Enter as Item 9)
HARRY H. NEUBERGER NEW YORK CITY 1932.		xxxxxx	.....

ITEM #14 TAXES.

Realty	276.33
Club Dues-Assessments	101.00
New York Personal	25.90
Auto License	32.50
Gasoline & Amusement	79.00
Check & Stock Transfer	85.55
	600.28

ITEM #17 CHARITABLE CONTRIBUTIONS.

Federation for Support of Jewish Phil. Societies	2,021.00
Montefiore Hospital	625.00
Emergency Unemployment Relief	315.00
Emergency Shelter Fund	25.00
Hundred Neediest Cases	100.00
Northwoods Sanitarium	50.00
Aged Couples Fund-New York Evening Post	25.00
Boys' Athletic Club	10.00
Home for Hebrew Infants	47.34
United Hospital Fund	25.00
American Red Cross	25.00
Phillips Exeter Xmas Fund	25.00
Blue Bird Camp	25.00
Grand Street Settlement	15.00
Henry Street Settlement	18.00
Council of Jewish Women	15.00
Needlework Guild of America	15.00
United Catholic Charities	50.00
New York Guild for Jewish Blind	10.00
Monmouth Memorial Hospital	10.00
National Jewish Hospital	10.00
Selig Solomon Society	5.00
Henry Meinhard Memorial	3.00
	$3,469.34

[redacted]

18

State how property was acquired .....

SCHEDULE D—CAPITAL NET GAIN OR LOSS FROM SALE OF ASSETS HELD MORE THAN TWO YEARS (See Instruction 8a)

SCHEDULE "D" HARRY H. NEUBERGER. NEW YORK CITY.

		ACQUIRED.	COST	SALE	PROFIT	LOSS.
282	Detroit Edison	1920/29	29,222.03	30,985.40	1,763.37	
436	Standard Oil, California	1920/23	9,379.15	8,139.98		1,239.17
5M	Midvale Steel Cvd. 5%	1920	3,620.00	4,456.25	836.25	
5M	Utah Power & Light 5%	"	3,770.00	3,546.25		223.75
8M	Rhein Elbe Union 7%	1926/27	8,276.80	3,239.25		5,037.55
25M	City of Tokio 5%	1920	16,062.50	8,843.75		7,218.75
150	Consolidated Gas, Pfd.	1928	5,962.77	12,610.00	6,647.23	
770	DO COM.	1921/29	23,494.53	25,761.10	2,266.57	
2500	Sperry Vacuum	1923	11,723.45	27,025.00	15,301.55	
205	Singer Mfg. Co.		66,459.33	25,210.89		41,248.44
	(200	1920/29				
	5-sold Feb-8-32)	Jan-19-30				
			$177,970.56	149,817.87	26,814.97	54,967.66
				NET CAPITAL LOSS	28,152.69	

[redacted]

SCHEDULE "C" HARRY H. HEUBERGER--NEW YORK CITY.

		Acquired	Cost	Sale	Profit	Loss
100	Lehman Corpn.	1931	3,676.00	3,707.50	31.50	
100	Eitengen Schild Dec.	1930	1,051.00	1,245.00	194.00	
	Jan.	1932				
100	Eastman Kodak	1932	7,686.00	8,070.00	384.00	
300	Gillette Safety Razor	"	15,303.00	15,635.00	332.00	
2500	Socony Vacuum	"	25,025.00	26,200.00	1,175.00	
200	Gillette Safety Razor	"	10,027.00	10,115.00	88.00	
100	Norfolk & Western	"	12,701.00	12,832.50	131.50	
100	Gillette Safety Razor	"	5,587.50	5,612.50	25.00	
500	Cons. Gas N.Y.	"	29,467.50	29,612.50	145.00	
600	Aircraft	"	9,066.00	9,317.50	251.50	
700	Cons. Gas N.Y.	"	41,557.00	42,390.00	833.00	
600	Lehman Corpn.	"	24,943.50	25,320.00	376.50	
300	Radio "B"	"	5,128.00	5,222.50	94.50	
1000	Kroger Groc.&Bkg.	"	26,447.50	12,837.50		13,610.00
100	Norfolk & Western	"	12,601.00	12,495.00		106.00
100	Beatrice Creamery	"	4,101.00	4,097.00		4.00
600	Gillette Safety Razor	"	32,656.00	31,320.00		1,336.00
100	N.Y.N.H.Hartford Ry.	"	3,001.00	2,895.00		106.00
200	Curtiss Wright	"	602.00	590.00		12.00
200	Dupont denemours	"	10,077.00	9,996.40		80.60
200	Aircraft	"	3,027.00	2,902.50		124.50
100	Cons. Gas N.Y.	"	5,551.00	5,520.00		31.00
500	Socony Vacuum	"	5,255.00	4,677.50		577.50
1600	Lorillard Inc.	"	23,716.00	22,145.00		1,571.00
200	N.Y.Central R.R.	"	5,752.00	5,102.50		649.50
200	Fourth Natl. Investors	"	3,702.00	3,697.92		4.08
2400	Socony Vacuum	"	23,411.50	23,114.50		297.00
200	Radio "B"	"	3,189.50	2,936.00		253.50
400	Cons. Gas N.Y.	"	27,066.50	23,167.50		3,899.00
400	American Rolling Mills	"	4,884.00	4,477.50		406.50
150	Commonwealth Edison	"	13,573.75	13,486.00		87.75
5000	Midwest Utilities Conv.5	"	1,631.25	1,546.26		84.99
200	Consol. Gas N.Y.	"	12,352.00	12,336.00		16.00
50	Amer. Car & Fdy.	"	1,983.25	1,398.00		585.25
300	Continental Oil	"	1,878.00	1,854.00		24.00
1300	Lorillard Inc.	"	18,925.50	20,546.50	1,621.00	
200	Lehman Corpn.	"	9,002.00	9,073.50	71.50	
1100	Consol. Gas N.Y.	"	68,848.50	69,898.00	1,049.50	
500	Socony Vacuum	"	4,380.00	4,987.50	607.50	
5000	Midwest Util.Conv.5	"	1,381.25	1,413.75	32.50	
1500	Socony Vacuum	"	15,015.00	15,400.00	385.00	
400	Consol. Gas N.Y.	"	23,891.50	24,372.00	480.50	
100	Lambert Co.	"	4,276.00	4,343.00	67.00	
100	Amer. Power & Lt.	"	951.00	1,118.00	167.00	
300	Internatl. Harvester	"	5,840.50	6,116.50	276.00	
300	Consol. Gas N.Y.	"	16,828.00	18,041.50	1,213.50	
800	New York Central	"	10,780.00	11,040.00	260.00	
400	Consol. Gas N.Y.	"	21,041.50	20,884.50		157.00
100	Tidewater Oil Pf.	"	3,782.25	3,493.00		289.25
400	New York Central	"	8,616.50	8,497.00		119.50
300	Lehman Corpn.	"	11,040.50	10,879.00		161.50
300	American Tobacco	"	20,803.00	20,642.50		160.50
1000	Lorillard Inc.	"	14,885.00	13,805.00		1,080.00
200	Montgomery Ward	"	1,552.00	1,386.00		166.00
100	Lehman Corpn.	"	4,151.00	4,043.00		108.00
100	Bankers Invest.N.Y.	"	5,367.50	5,044.40		323.10

6890323 6728987 10292.50 4264892

16136.57

52

53 EXHIBIT A, ANNEXED TO STIPULATION OF FACTS

(Continued).

(PHOTOPRINTS.)

[*For the Convenience of Court and Counsel this Exhibit (Photostatic Copies) is Bound in on the Opposite Page.*]

54

Exhibit A, Annexed to Stipulation of Facts
(Cont'd).

20

SCHEDULE "C"--HARRY H. [redacted]-- New York City

		Cost	Sale	Profit	Loss
700	Consolidated Gas N.Y. 1932	32,969.50	32,376.00		593.50
500	Lorillard, Inc. "	7,505.00	6,790.00		715.00
100	American Teb. Co. "	6,876.00	6,872.50		3.50
300	American Tel. & Tel. "	30,053.00	28,991.50		1,061.50
200	Union Carbide "	3,802.00	3,586.00		216.00
200	Bank of Manhattan "	4,125.00	3,922.60		202.40
100	Natl. City Bank "	3,402.50	3,170.58		231.92
700	Consol. Gas N.Y. "	36,644.50	37,563.50	919.00	
1500	Socony Vacuum "	13,390.00	14,400.00	1,010.00	
500	Amer. Tobacco B. "	34,192.50	34,725.00	532.50	
300	Socony Vacuum "	2,515.50	2,617.50	102.00	
300	Gillette Safety Pf. "	16,360.75	18,179.00	1,818.25	
700	Amer. Tobacco B. "	45,469.50	46,207.50	738.00	
600	Consol. Gas N.Y. "	30,143.50	31,333.00	1,189.50	
700	Socony Vacuum "	5,932.00	6,107.50	175.50	
500	Fourth Natl. Invest. "	7,867.50	7,994.70	127.20	
100	" " "	1,501.00	1,561.44	60.44	
500	Lehman Corpn. "	15,917.50	16,027.50	110.00	
100	Amer. Tobacco Com. "	6,176.00	6,347.50	171.50	
1000	" " "B" "	58,397.50	59,887.50	1,490.00	
100	Fourth Natl. Invest. "	1,438.50	1,486.44	47.94	
800	Consol. Gas. N.Y. "	36,895.50	37,494.00	598.50	
400	Lorillard, Inc. "	3,979.00	4,122.00	143.00	
400	" " "	3,966.50	4,084.50	118.00	
500	Consol. Gas N.Y. "	16,505.00	23,265.00	6,760.00	
200	American Tobacco B. "	9,902.00	10,345.00	443.00	
500	Socony Vacuum "	3,030.00	4,362.50	1,332.50	
200	American Tobacco B. "	10,152.00	10,470.00	318.00	
200	Consol. Gas N.Y. "	7,639.50	7,686.00	46.50	
100	Tidewater Oil Pf. "	3,213.50	3,293.00	79.50	
200	American Tel & Tel "	16,902.00	16,936.00	34.00	
200	Chicago Northwestern Pf. "	1,252.00	1,582.00	330.00	
400	Lehman Corpn. "	14,004.00	14,185.00	181.00	
200	National Bond & Share "	3,919.17	4,772.00	852.83	
500	Stand Oil-Indiana "	10,025.00	10,713.75	688.75	
800	F. Shattuck, Inc. "	3,993.75	4,705.00	711.25	
800	Kroger Groc. & Bkg. "	7,255.00	7,955.00	700.00	
1000	Tidewater Oil "	4,247.50	4,910.00	662.50	
10000	Chicago N.Western Cv.4½ "	1,037.50	1,483.50	446.00	
1000	Lorillard, Inc. 1931	19,691.25	11,830.00		7,861.25
400	Consol. Gas N.Y. 193	14,704.00	14,334.50		369.50
100	Fourth Natl. Invest. "	1,276.00	1,061.44		214.56
400	American Tel & Tel "	35,166.50	34,634.50		532.00
500	Lorillard, Inc. "	5,567.50	5,477.50		90.00
400	American Tobacco B. "	20,529.00	19,965.00		564.00
200	Amer. Tel & Tel "	16,902.00	16,586.00		316.00
100	Lehman Corpn. "	3,426.00	3,340.00		86.00
300	J. C. Penney "	5,298.75	5,073.00		225.75
100	Gillette Razor Pfd. "	6,501.00	6,290.00		211.00
3000	Socony Vacuum "	30,030.00	19,925.00		10,105.00
500	Union Carbide "	12,817.50	12,325.00		492.50
500	Montgomery Ward "	5,692.50	5,492.50		200.00
10000	Third Ave. Ry. Adj.5s "	3,012.50	2,006.25		1,006.25
11000	Tobacco Products 6s "	9,544.03	8,847.82		696.21
225	New York Steam "	11,413.13	6,800.25		4,612.88
300	Dupont "	12,265.50	11,766.60		498.90
300	N.Y. Chicago & St. Louis "	4,253.00	4,147.00		106.00
700	Sears-Roebuck "	17,132.00	15,392.50		1,739.50
100	Pere Marquette Pr.Pf. "	2,101.00	1,488.00		613.00
1600	Gillette Razor "	31,091.00	29,406.00	22937 16	1,685.00
50	Pere Marquette "	567.17	495.50		71.67

79159950 79191587 353207 9

1-38303 [redacted]

PAGE #3 SCHEDULE "C" HARRY H. NEUBERGER NEW YORK CITY

		ACQUIRED.	COST.	SALE.	PROFIT	LOSS.
1000	Internatl Tel & Tel	1932	13,760.00	10,747.50		3,012.50
500	Kennecott Copper	"	9,317.50	5,955.00		3,362.50
1000	Montgomery-Ward	"	13,260.00	12,385.00		875.00
1500	Dupont.	"	63,877.50	62,795.50		1,082.00
50	December Wheat	"	29,264.50	28,937.50		327.00
1000	Commonwealth & Southern	"	3,010.00	3,760.00	750.00	
4500	Montgomery-Ward	"	50,371.00	53,657.50	3,286.50	
1000	J.C.Penney	"	20,135.00	21,650.00	1,515.00	
2000	Sears-Roebuck	"	44,895.00	47,637.50	2,742.50	
1000	Western-Union Tel	"	35,048.00	36,225.00	1,177.00	
200	B.F.Goodrich Pfd	"	3,527.00	3,757.00	230.00	
1000	Socony Vacuum	"	11,635.00	11,720.00	85.00	
500	Tidewater Oil	"	2,067.50	2,367.50	300.00	
150	Pere Marquette Pfd	"	1,951.50	3,173.50	1,222.00	
700	Lehman Ins.	"	33,307.00	34,692.50	1,385.50	
2000	Johns Manville	"	50,395.00	51,300.00	905.00	
200	Western Union Tel	"	7,689.50	8,167.50	478.00	
1600	Sears Roebuck	"	35,303.50	36,152.50	849.00	
2200	Internatl.Tel & Tel	"	26,122.00	26,302.00	180.00	
650	Pere Marquette	"	6,539.83	8,360.25	1,820.42	
10	Midwest Utilities Conv.5%	"	462.50	783.90	321.40	
50	Pere Marquette Pfd	"	650.50	747.55	97.05	
50	J.I.Case Pfd	"	3,452.00	3,491.50	39.50	
1500	Aircraft	"	37,428.00	38,337.50	909.50	
1100	Johns Manville	"	32.923.50	33.140.00	216.50	
700	Aircraft	"	15,394.50	15,830.00	435.50	
100	Celanese	"	3,392.50	4,940.99	1,548.49	
900	Aircraft	"	24,009.00	24,710.00	701.00	
100	DO	"	2,438.50	2,440.00	1,50	
500	Socony-Vacuum	"	5,067.50	5,410.00	342.50	
50	Pere Marquette Pfd	"	326.00	386.50	60.50	
100	Aircraft	"	3,288.50	2,602.50		686.00
500	Lorillard Ins.	"	8,255.00	6,555.00		1,700.00
200	Canadian Pacific 6%	"	18,118.00	17,964.50		153.50 X
1500	Lorillard Ins.	"	20.465.00	19,552.50		912.50
500	General Realty	"	980.00	330.00		650.00
100	American Car & Fdy.	"	4,897.75	1,941.00		2,956.75
600	N.Y.Steam Corpn.	1931	32.100.00	30,178.59		1,921.41
500	Federated Stores	"	550.00	194.02		355.98
100	U.S.& Foreign Secur.	"	5,138.50	4,990.00		148.50
200	Natl. Union Radio	"	200.00	136.50		63.50
100	Spur Distilling	"	500.00	442.00		58.00
950	European Electric WTS.	1932	475.00	343.95		131.05
	Premiums & Brokerages	"	449.90			449.90
			682,436.48	683,194.75	21599.36	1841.09
			82,169,553.23 X	82,142,456.35 X	54,829.02	81,929.90 X
			21600533	21372933	27,096.88	80572.16
	NET LOSS					

THIS NET LOSS is taken against the PARTNERSHIP PROFITS from HINSON & NEUBERGER

25763

Findings of Fact and Opinion.

58

UNITED STATES BOARD OF TAX APPEALS.

HARRY H. NEUBERGER, PETITIONER, v. COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

Docket No. 78919. Promulgated January 28, 1938.

1. Where a petitioner shares in partnership profits, which were derived by it from the sale of noncapital assets, he may not offset such share of profits by losses personally sustained in the sale of similar assets in computing his individual net taxable income.

2. Commissions paid upon the purchase and sale
59 of securities by one who is a trader in that business, are deductible as ordinary and necessary business expenses. Following *Winmill* v. *Commissioner*, ... Fed. (2d) ..., reversing the Board on this point.

W. H. Freidman, Esq., for the petitioner.

J. R. Johnston, Esq., for the respondent.

The respondent having determined a deficiency in income tax of $9,021.24 for the taxable year 1932, the petitioner brings this proceeding for the redetermination thereof, claiming error by reason of (a) the erroneous disallowance of a loss upon the sale of securities held less than two years
60 and, in the alternative, (b) the erroneous disallowance of taxes and commissions paid in connection with the purchase and sale of securities and, also in the alternative, (c) the erroneous disallowance of a loss of $327 sustained on a certain commodity transaction.

FINDINGS OF FACT.

The petitioner, an individual, resident of New York, New York, was a member of the New York Stock Exchange. He was engaged in the business of trading in securities on

the floor of the Exchange for the partnership of Hilson & 61
Neuberger, of which he was a member, executing orders on behalf of customers of the partnership and for his individual account.

During the taxable year the petitioner sustained a net loss, from his individual trading, from sales or exchanges of stocks and bonds which were not capital assets (as defined in section 101 of the Revenue Act of 1932), in the aggregate sum of $25,588.93. In computing such loss he deducted stock transfer taxes and commissions on sales of securities from the selling price and he added commissions paid upon the purchases of securities to the cost and treated them as a part of the cost of securities sold. Federal 62
and New York stock transfer taxes on such sales amounted to $2,779.69. Commissions paid during the year upon purchases and sales, respectively, were $2,133.63 and $2,306.98. These taxes and commissions—the latter having been paid to the aforesaid firm of Hilson & Neuberger and reported by it for income tax purposes in its return for that year—were not separately deducted in the petitioner's return for 1932.

The petitioner's firm derived a profit of $142,802.29 in the taxable year from the sale of stocks and other securities which were not capital assets of the type hereinbefore indicated. It had other income (including commissions received) of $170,830.65 and deductions of $203,981.78, or net 63
income of $109,651.06 [.16]. The petitioner's distributive share of said profits amounted to $36,000 of the first $94,000 and 45 percent of the remainder.

In addition to the above and foregoing the parties have stipulated the following:

> During the calendar year 1932, petitioner incurred a loss of $327 upon the sale of a grain futures contract held less than two years. This loss was disallowed by the Commissioner in the determination of the deficiency here involved, but is now conceded as

64 not being within the limitations set forth under Section 23 (r) of the Revenue Act of 1932, and this loss may now be allowed on the Rule 50 computation.

Petitioner's distributive share of the partnership profits for 1932 was increased by the Commissioner by $488.38, which item is not in dispute.

The petitioner now claims the right to deduct from taxable income for the year 1932, the aforesaid loss of $25,588.93 from individual trading in stocks and other securities, which deduction has been disallowed by the Commissioner; and in the alternative, the petitioner now claims the right to deduct the taxes and commissions referred to * * *.

65

OPINION.

ARNOLD: The first error complained of by the petitioner relates to a loss sustained by him, personally, in the disposition of securities which were not capital assets as defined in section 101 of the Revenue Act of 1932, disallowed by the respondent as an offset against, and in the reduction of, partnership profits, to which he was entitled, and which were derived by it from the sale of noncapital securities. This question is now well settled and must be resolved in favor of the respondent, upon the authority of *Percy H. Johnston*, 34 B. T. A. 276; affd. 86 Fed. (2d) 732; certiorari denied, 301 U. S. 683, and *Winmill* v. *Commissioner*, ... Fed. (2d) ... (Dec. 6, 1937), affirming the Board at 35 B. T. A. 804, on this point.

66

The respondent now concedes the petitioner's right to deduct stock transfer taxes paid by him to the Federal and State Governments during the taxable year, amounting to $2,779.69. So that the sole remaining question is whether or not the petitioner is entitled to deduct commissions paid upon purchases and sales of securities, as ordinary and necessary expenses incurred in his business as a trader in securities, under section 23 (a) of the Revenue Act of 1932,

or whether he must treat such commissions on the former as a part of cost and on the latter as an offset against the selling price, as provided in article 282 of Regulations 77, and prior regulations. This identical question was before us in *Robert C. Winmill*, 35 B. T. A. 804, wherein we sustained the action of the respondent under his regulations and denied the contention of the petitioner. In its opinion, upon appeal, the Second Circuit reversed the Board on this point, holding commissions paid on both purchases and sales, by one engaged as a trader in the business of buying and selling securities, to be ordinary and necessary business expenses, applying the same principles to a trader in securities as heretofore applied to other businesses in *Highlands Trust No. 1546*, 32 B. T. A. 760; also *Alexander Sprunt & Son, Inc.*, 64 Fed. (2d) 424; *Kornhauser* v. *United States*, 276 U. S. 145; and *Clarence Whitman*, 16 B. T. A. 197; affd. 49 Fed. (2d) 1087. The Board having failed to find, as a fact, whether or not the petitioner there was a trader in the business of buying and selling securities, the court remanded the proceeding for that purpose and directed that if so found such commissions should be allowed as deductions. Complying with the mandate of the court, the Board so found and entered its order on December 31, 1937, directing recomputations by deducting from taxable income the commissions upon purchases and sales of securities.

We have found, from the nature of the petitioner's business and the volume of transactions entered into by him, individually, that he was a trader in the business of buying and selling securities. This, it would seem, the respondent has never disputed.

The respondent's determination shall be modified accordingly.

Reviewed by the Board.

Judgment will be entered under Rule 50.

(Seal)

Decision.

70 UNITED STATES BOARD OF TAX APPEALS,

Washington.

Docket No. 78919.

HARRY H. NEUBERGER,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

71

Pursuant to the Board's Findings of Fact and Opinion promulgated January 28, 1938, the respondent herein having on March 2, 1938 filed recomputation of tax and the petitioner having on March 5, 1938 filed an acquiescence in said recomputation, now therefore, it is

ORDERED AND DECIDED: That the petition herein respecting income tax liability for the year 1932 was filed March 28, 1935; that no claim for refund has been filed; that tax was paid in the amounts of $545.56 on March 15, 1933, $4,000.00 on February 16, 1937 and $3,000.00 on May 4,
72 1937, making a total tax paid of $7,545.56; that the true tax liability is $6,721.46; and therefore in accordance with Section 504 (a) of the Revenue Act of 1934 there is an overpayment of $824.10 for the year 1932.

Enter

(s) WILLIAM W. ARNOLD,
Member.

Entered March 9, 1938.
(Seal)

Petition for Review.

73

UNITED STATES CIRCUIT COURT OF APPEALS,

FOR THE SECOND CIRCUIT.

Docket No. 78,919.

HARRY H. NEUBERGER,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

74

To the Honorable Judges of the United States Circuit Court of Appeals for the Second Circuit:

NOW COMES Harry H. Neuberger, by his attorneys, WALTER MENDELSOHN and WILBUR H. FRIEDMAN, and respectfully shows:

I.

JURISDICTION.

75

This is a petition to review the judgment of the United States Board of Tax Appeals which was entered in the above entitled case on March 9, 1938. The petitioner is an individual residing within the Southern District of New York, and filed his 1932 income tax return (the one in question) with the Collector of Internal Revenue for the Second District of New York, whose office is also located within the Southern District.

Jurisdiction to review said decision of the Board is conferred upon this Court by §§1001, 1002 and 1003 of the Revenue Act of 1926, as amended.

76

II.

Nature of Controversy.

Petitioner filed a petition with the United States Board of Tax Appeals for review of a determination by the respondent of a deficiency in income taxes for the year 1932, in the amount of $9,021.24. Prior to the decision of the Board, petitioner paid a total tax of $7,545.56. The Board held that the true tax liability was $6,721.46, and therefore found an overpayment of $824.10.

The question involved is whether petitioner is entitled,
77 in the computation of his taxable income for the year 1932, to apply losses sustained by him in that year in the course of trading in stocks and securities held less than two years, against his distributive share of partnership income for the year 1932, which partnership income included gains realized in the course of trading in stocks and securities held less than two years. The amount of these gains exceeded his individual losses.

The Commissioner, relying upon §23(r) of the Revenue Act of 1932, held that this could not be done, and the Board, while deciding in favor of the taxpayer on other issues not herein involved, sustained the Commissioner.

The facts were stipulated before the Board. The essen-
78 tial facts are that during 1932, the petitioner trading in securities in his individual capacity, incurred a net loss of $25,558.93. During that year he was a member of a Stock Exchange partnership, which partnership also traded in securities. The trading, both for the partnership account and his own, was carried on by the petitioner. The partnership in 1932 sold securities held less than two years at a profit, of which petitioner's distributive share was in excess of $25,588.93, the amount of petitioner's individual trading losses.

The Board found as a fact that petitioner was a trader in the business of buying and selling securities. It is contended that the Board erred in failing to interpret §23(r) as being inapplicable to a trader in securities, at least under the facts of this case. 79

It is further contended that if §23(r) applies to a trader in securities, then that section is unconstitutional in that it is arbitrary and capricious, depriving petitioner of property without due process of law, in violation of the Fifth Amendment to the Federal Constitution. This is for the reasons, among others, that:

(1) §23(r), as interpreted by the Board, requires petitioner to report all his income from his partnership business of trading, but denies him the right to deduct therefrom a loss from his individual business of trading. 80

(2) §23(r), as interpreted by the Board, unreasonably discriminates between dealers in securities and persons trading in securities as a business.

(3) §23(r), as interpreted by the Board, unreasonably discriminates between sellers of (1) stocks and bonds held less than two years and (2) other speculative property held less than two years.

ASSIGNMENTS OF ERROR. 81

I. The Board erred in interpreting §23(r) of the Revenue Act of 1932 as denying to a member of a partnership the right to apply his individual loss from sales of stocks and securities held less than two years against his distributive share of partnership income resulting from similar sales where said member was in business of trading in securities and traded on the floor of the Stock Exchange both for his own account and the account of the partnership.

82 II. The Board erred in approving the determination of the Commissioner that the petitioner could not offset his individual security trading losses against his distributive share of the partnership's security trading profits.

III. The Board erred in failing to hold that §23(r), as interpreted by the Board, violates the due process clause of the Fifth Amendment.

IV. The Board erred in failing to hold that §23(r), as interpreted by the Board, violates the due process clause of the Fifth Amendment, in that it denies to taxpayer the right to deduct from his income earned in the business of
83 security trading a loss related to the same income and incurred in the same business.

V. The Board erred in failing to hold that §23(r), as interpreted by the Board, violates the due process clause of the Fifth Amendment, in that it unreasonably and capriciously discriminates between dealers in securities and persons in the business of trading in securities.

VI. The Board erred in failing to hold that §23(r), as interpreted by the Board, violates the due process clause of the Fifth Amendment in that it unreasonably and capri-
84 ciously discriminates between sellers of (1) stocks and bonds held less than two years and (2) other speculative property held less than two years.

VII. The Board erred in failing to find that there had been an overpayment in tax of $7,545.56.

WHEREFORE, the petitioner prays that the decision of the United States Board of Tax Appeals be reviewed by this Honorable Court, that a transcript of the record be prepared in accordance with law and transmitted to the

Clerk of said Court, and that appropriate action be taken 85
to the end that the errors complained of may be reviewed and corrected by this Honorable Court, and the decision of the said Board reversed.

WALTER MENDELSOHN
WILBUR H. FRIEDMAN
Counsel for Petitioner
11 Broadway
New York, N. Y.

State of New York,
County of New York—ss.: 86

HARRY H. NEUBERGER, being duly sworn, deposes and says: That he is the petitioner above-named; that he has read the foregoing petition, and is familiar with the contents thereof, and that said petition is true to his own knowledge, except as to the matters therein alleged on information and belief, and as to those matters, he believes it to be true.

HARRY H. NEUBERGER.

Sworn to before me this
6th day of June, 1938. 87

C. L. FLUKE,
Notary.
Kings County Clerk's #186 etc.
Cert. filed in N. Y. County #630.
N. Y. County Register's #0F351.
My commission expires Mar. 30, 1940.
(Seal)

Praecipe.

88 UNITED STATES CIRCUIT COURT OF APPEALS,

FOR THE SECOND CIRCUIT.

B. T. A. Docket No. 78,919.

HARRY H. NEUBERGER,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

To the Clerk of the United States Board of Tax Appeals:

89 You will please prepare a transcript of record on petition for review in the above-entitled case for certification to the United States Circuit Court of Appeals for the Second Circuit, said transcript to include the following:

1. The docket entries of the proceedings before the United States Board of Tax Appeals in Docket No. 78,919.
2. The taxpayer's amended petition to the Board of Tax Appeals and respondent's answer thereto.
3. The stipulation of facts.
4. The findings of fact, opinion, and decision of the Board of Tax Appeals.

90 5. The petition for review.

6. The praecipe.

WALTER MENDELSOHN,
WILBUR H. FRIEDMAN,
Counsel for Petitioner,
11 Broadway,
New York, N. Y.

Receipt of copy of the foregoing praecipe is hereby acknowledged this 14 day of July, 1938.

J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

Clerk's Certificate.

91

UNITED STATES BOARD OF TAX APPEALS

WASHINGTON

Docket No. 78919.

HARRY H. NEUBERGER,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

92

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 33 inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 2nd day of August, 1938.

93

B. D. GAMBLE,
Clerk,
United States Board of Tax Appeals.
(SEAL)

94 **Stipulation Consolidating Records.**

IN THE

UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE SECOND CIRCUIT.

No. 117.

HARRY NEUBERGER,

Petitioner,

v.

95 COMMISSIONER OF INTERNAL REVENUE,

Respondent.

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

v.

HARRY NEUBERGER,

Respondent.

---

96 It is hereby stipulated and agreed by and between counsel for the respective parties to the above-entitled proceedings that the record on appeal certified by the Clerk of the Board of Tax Appeals in connection with the petition for review filed by Harry H. Neuberger as petitioner and the record on appeal certified by the Clerk of the Board of Tax Appeals in connection with the petition for review filed by the Commissioner of Internal Revenue as petitioner, may be consolidated for printing; and that the printed record shall consist of the record on review certified by

the Clerk of the Board of Tax Appeals in connection with 97
the petition filed by Harry H. Neuberger, petitioner, plus the petition for review filed by the Commissioner of Internal Revenue, the notices of filing of petition for review filed by the Commissioner of Internal Revenue, the praecipe for record filed by the Commissioner of Internal Revenue, and this stipulation.

It is further stipulated that the cost of printing the record shall be shared equally by the parties to the above proceedings.

WILBUR H. FRIEDMAN,
Counsel for Harry H. Neuberger.

98

JAS. W. MORRIS,
Counsel for the Commissioner
of Internal Revenue.

So Ordered:

LEARNED HAND,
U. S. C. J.

March 27, 1939.

99

Petition for Review and Assignments of Error.

100

IN THE

UNITED STATES CIRCUIT COURT OF APPEALS,

FOR THE SECOND CIRCUIT.

B. T. A. Docket No. 78919.

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner on Review,

v.

101 HARRY H. NEUBERGER,
Respondent on Review.

To the Honorable Judges of the United States Circuit Court of Appeals for the Second Circuit:

NOW COMES Guy T. Helvering, Commissioner of Internal Revenue, by his attorneys, James W. Morris, Assistant Attorney General, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and J. R. Johnston and Albert E. Arent, Special Attorneys for the Bureau of Internal Revenue, and respectfully shows:

102

I

JURISDICTION.

The petitioner on review (hereinafter referred to as the Commissioner) is the duly appointed, qualified and acting Commissioner of Internal Revenue of the United States of America, holding his office by virtue of the laws of the United States of America.

The respondent on review, Harry H. Neuberger (hereinafter referred to as the taxpayer), is an individual who 103
filed a return for Federal income taxes for the year 1932 with the United States Collector of Internal Revenue for the Second District of New York, whose office is within the jurisdiction of the United States Circuit Court of Appeals for the Second Circuit.

The Commissioner files this petition pursuant to the provisions of Sections 1001, 1002, and 1003, of the Revenue Act of 1926, as amended by Section 603 of the Revenue Act of 1928, as amended by Section 1101 of the Revenue Act of 1932, as amended by Section 519 of the Revenue Act of 1934.

II 104

PRIOR PROCEEDINGS.

On March 4, 1935, a notice of deficiency was sent to the taxpayer by registered mail as provided in Title I of the Revenue Act of 1932, showing a deficiency in Federal income tax for the year 1932 in the amount of $9,021.24. An appeal from this determination was filed by the taxpayer with the United States Board of Tax Appeals on March 28, 1935. On April 26, 1935 the Commissioner filed an answer to the petition, in which certain allegations of the petition were admitted and others denied.

On February 15, 1937 the case was submitted on a stipu- 105
lation of facts to a division of the Board of Tax Appeals at New York, New York. At the same time the taxpayer filed an amended petition. On January 7, 1938 the respondent was granted leave to file an answer to said amended petition.

On January 28, 1938 the Board promulgated its findings of fact and opinion and, pursuant thereto, entered its decision on March 9, 1938, ordering and deciding that there is an overpayment of $824.10 for the year 1932.

106

III.

Nature of the Controversy.

The question presented on this appeal is whether petitioner is entitled to deduct commissions paid upon purchases and sales of securities as ordinary and necessary expenses incurred in his business as a "trader" in securities, under Section 23(a) of the Revenue Act of 1932. The Commissioner contends, in accordance with Article 282 of Regulations 77, that commissions paid upon purchases of securities by one who is not a dealer in securities
107 are a part of the cost and are not deductible as business expenses, and that commissions paid upon sales of securities are an offset against the selling price and are likewise not deductible as business expenses. The Board has held that commissions in the amounts of $2,133.63 and $2,306.98 paid upon purchases and sales of securities, respectively, may be deducted by the taxpayer, a "trader" in the business of buying and selling securities.

IV.

Assignments of Error.

108 The Commissioner says that manifest errors occurred and intervened to his prejudice in the opinion, decision, and final order of redetermination rendered and entered by the Board of Tax Appeals, and assigns the following errors, each of which he avers occurred in said opinion, decision, and final order of redetermination, and upon which he relies as grounds for reversing the said decision and final order of redetermination, to wit:

1. The Board of Tax Appeals erred in holding and deciding that commissions paid upon purchases of securities by one engaged as a trader in the busi-

ness of buying and selling securities are deductible as ordinary and necessary business expenses, under Section 23(a) of the Revenue Act of 1932. 109

2. The Board of Tax Appeals erred in holding and deciding that commissions paid upon sales of securities by one engaged as a trader in the business of buying and selling securities are deductible as ordinary and necessary business expenses, under Section 23(a) of the Revenue Act of 1932.

3. The Board of Tax Appeals erred in failing to hold and decide that commissions paid upon purchases of securities by one engaged as a trader, and not as a dealer, in the business of buying and selling securities are part of the cost of said securities, as provided in Article 282 of Regulations 77 and prior regulations, and are not deductible as ordinary and necessary expenses incurred in a trade or business. 110

4. The Board of Tax Appeals erred in failing to hold and decide that commissions paid on sales of securities by one engaged as a trader, and not as a dealer, in the business of buying and selling securities are an offset against the selling price, as provided in Article 282 of Regulations 77 and prior regulations, and are not deductible as ordinary and necessary expenses incurred in a trade or business. 111

5. The Board of Tax Appeals erred in holding and deciding that the amounts of $2,133.63 and $2,306.98, paid by the taxpayer during the year 1932 as commissions upon purchases and sales of securities, respectively, should be deducted from gross income in determining the taxpayer's income tax liability for the year 1932.

6. The Board of Tax Appeals erred in ordering and deciding that the taxpayer's true tax liability

112 for the year 1932 is $6,721.46 and that there is an overpayment for said year in the amount of $824.10.

7. The Board of Tax Appeals erred in failing to order and decide that there is a deficiency in income taxes owed by the taxpayer for the year 1932, as determined by the Commissioner, rather than an overpayment.

WHEREFORE, the Commissioner petitions that the decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Second Circuit, that a transcript of the record be prepared in accordance
113 with law and with the rules of said Court and transmitted to the Clerk of said Court for filing, and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected by said Court.

(Sgd.) JAMES W. MORRIS,
Assistant Attorney General.

(Signed) J. P. WENCHEL,
R. L. W.

J. P. WENCHEL,
Chief Counsel,
114 Bureau of Internal Revenue.

Of Counsel:
J. R. JOHNSTON,
ALBERT E. ARENT,
Special Attorneys,
Bureau of Internal Revenue.

United States of America,
District of Columbia—ss.: 115

ALBERT E. ARENT, being duly sworn, says that he is a special attorney of the Bureau of Internal Revenue, and as such is duly authorized to verify the above and foregoing petition for review to the United States Circuit Court of Appeals for the Second Circuit; that he has read the said petition for review and is familiar with the statements therein contained, and that he knows of his own knowledge that the facts therein stated are true, except such facts as may be stated on information and belief, and those facts he believes to be true.

116

(s) ALBERT E. ARENT,
Special Attorney,
Bureau of Internal Revenue.

Sworn to and subscribed before me this
28th day of May, 1938.

(s) GEORGE W. KREIS.
Notary Public,
District of Columbia.
My Commission expires Nov. 15, 1942.

117

Notice of Filing Petition for Review.

118 IN THE

UNITED STATES CIRCUIT COURT OF APPEALS,

FOR THE SECOND CIRCUIT.

B. T. A. Docket No. 78919.

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner on Review,

v.

HARRY H. NEUBERGER,
Respondent on Review.

---

119 To:

Mr. Harry H. Neuberger,
c/o Proskauer, Rose & Paskus,
11 Broadway,
New York, New York.

You are hereby notified that the Commissioner of Internal Revenue did, on the 31st day of May, 1938, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Second Circuit, of the decision of the Board heretofore rendered in the above-
120 entitled case. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 31st day of May, 1938.

(Signed) J. P. WENCHEL
R L W

J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 2nd day of June, 1938. 121

(Sd) HARRY H. NEUBERGER,
Respondent on Review.

Notice of Filing Petition for Review.

IN THE 122

UNITED STATES CIRCUIT COURT OF APPEALS,

FOR THE SECOND CIRCUIT.

B. T. A. Docket No. 78919.

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner on Review,

v.

HARRY H. NEUBERGER,
Respondent on Review. 123

To:

Walter Mendelsohn, Esq., and
Wilbur H. Friedman, Esq.,
11 Broadway,
New York, New York.

You are hereby notified that the Commissioner of Internal Revenue did, on the 31st day of May, 1938, file with the Clerk of the United States Board of Tax Appeals, at

Notice of Filing Petition for Review.

124 Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Second Circuit, of the decision of the Board heretofore rendered in the above-entitled case. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 31st day of May, 1938.

(Signed) J. P. WENCHEL
R L W

125 J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 2nd day of June, 1938.

(Sd) WALTER MENDELSOHN,

.....

126 Attorneys for Respondent on Review.

Praecipe for Record.

127

IN THE

UNITED STATES CIRCUIT COURT OF APPEALS,

FOR THE SECOND CIRCUIT.

Docket No. 78919.

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

HARRY H. NEUBERGER,
Respondent. 128

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Second Circuit, copies duly certified as correct of the following documents and records in the above-entitled cause in connection with the petition for review by the said Circuit Court of Appeals for the Second Circuit, heretofore filed by the Commissioner of Internal Revenue:

129

1. Docket entries of proceedings before the Board.

2. Pleadings before the Board:

   (a) Amended Petition, including annexed copy of deficiency letter and statement thereto attached.

   (b) Answer to Amended Petition, filed and allowed January 5, 1938.

Praecipe for Record.

130

3. Stipulation of facts dated February 15, 1937, and filed at the hearing.

4. Findings of fact, opinion and decision of the Board.

5. Petition for review filed by the Commissioner, together with proof of service of notice of filing petition for review and of service of a copy of petition for review.

6. This praecipe.

131

(Signed) J. P. WENCHEL
R L W
J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

Service of a copy of the within praecipe is hereby acknowledged this 11th day of July, 1938.

WILBUR H. FRIEDMAN,
Attorney for Respondent.

132

Clerk's Certificate.

133

UNITED STATES BOARD OF TAX APPEALS.

WASHINGTON.

Docket No. 78919.

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

v.

HARRY H. NEUBERGER,

Respondent.

134

I, B. D. GAMBLE, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages 34 to 44, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the cross appeal as above numbered and entitled, and as agreed upon by the parties.

IN TESTIMONY WHEREOF, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 8th day 135
of ~~April, 1939~~. August, 1938.

B. D. GAMBLE,
Clerk,
United States Board of Tax Appeals.

(Seal)

[fol. 46] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

No. 117. October Term, 1938.

Argued May 26, 1939. Decided June 12, 1939

HARRY H. NEUBERGER, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

v.

HARRY H. NEUBERGER, Respondent

Appeal from the Board of Tax Appeals

Before Swan, Chase, and Patterson, Circuit Judges

Both the taxpayer and the commissioner seek review of a decision of the Board determining the income tax liability of Harry H. Neuberger for the year 1932. Modified.

For the opinion below see 37 B. T. A. 223.

Proskauer, Rose & Paskus, of New York City (Walter Mendelsohn, Wilbur H. Friedman, and Martin Norr, all of New York City, of counsel), for taxpayer.

James W. Morris, Asst. Atty. Gen., and Sewall Key and F. E. Youngman, Sp. Assts. to Atty. Gen. for the Commissioner.

Per CURIAM:

During the year 1932 the taxpayer, who was a member of the New York Stock Exchange, was engaged in the business of trading in securities on the floor of the Exchange for a partnership of which he was a member and also for his individual account. The taxpayer's petition presents two questions: (1) whether a loss sustained by him during the year on his individual transactions in stocks and bonds which were non-capital assets as defined in section 101 of

the Revenue Act of 1932, 26 U. S. C. A. § 101 note, may be offset against his share of partnership profits realized during the same period from sales or exchanges of similar non-capital assets; and (2) whether section 23(r) of the 1932 Act, 26 U. S. C. A. § 23 note, if construed to prevent such offsetting, as the Board held it did, is unconstitutional. Both questions must be answered in the negative upon the authority of prior decisions by this court. Johnston v. Commissioner, 2 Cir., 86 F. 2d 732, certiorari denied 301 U. S. 683, 57 S. Ct. 784, 81 L. Ed. 1341; Davis v. United States, 2 Cir., 87 F. 2d 323, certiorari denied 301 U. S. 704, 57 S. Ct. 937, 81 L. Ed. 1350.

The commissioner's petition likewise presents two questions, one relating to commissions paid on the purchase of securities, the other to commissions paid on the sale of securities. Relying upon this court's decision in Winmill v. [fol. 47] Commissioner, 2 Cir., 93 F. 2d 494, the Board held that both commissions on purchases and commissions on sales may be deducted as ordinary and necessary business expenses. Subsequently the Winmill case was reversed with respect to commissions on purchases; they must be treated as part of the cost of the securities purchased. Helvering v. Winmill, 305 U. S. 79, 59 S. Ct. 45, 83 L. Ed. —. The fact that such commissions were paid to the taxpayer's partnership and reflected in its income does not change their character as capital expenditures by the taxpayer. To conform to the ruling of the Supreme Court, the deduction of commissions on purchases must be disallowed. With respect to commissions on sales we adhere to our decision in the Winmill case.

The cause is remanded for modification of the Board's order in conformity with this opinion.

[fol. 48] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

No. 117

HARRY H. NEUBERGER, Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE, Respondent

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

against

HARRY H. NEUBERGER, Respondent

(Consolidated Cases.)

On Cross-Petitions for Review of Decision of the United States Board of Tax Appeals

TAXPAYER'S PETITION FOR REARGUMENT

This petition is filed for the reason that the Court's per curiam opinion rendered June 12, 1939, fails to cover vital points presented in taxpayer's argument. As to the purchase commissions, the Court's opinion makes new and unjust law without discussion.

[fol. 49] I

The 1938 Act

The question whether § 23(r) prevents deduction of individual trading losses in this case is one of Congressional intent. The Court disposes of the point by citing the Johnston case.

In the first general Revenue Law since the Johnston case, Congress made it clear that it disagreed with this Court's finding as to its intention.

Accordingly, the Johnston case is no longer authority on the point, and taxpayer submits that this Court should set forth its reasons for disregarding Congress' own statement as to its intention.

The per curiam opinion fails to mention the 1938 Act.

II

The Applicable Decisions

Both the Supreme Court in Jordan v. Roche and the Sixth Circuit in the Coulby case, in situations identical with the present, held that the later Act (here the 1938 Act) controls as to the intention of Congress.

Upon the oral argument, counsel requested the Court to discuss these cases in order that, if this Court were unwilling to take the responsibility of overruling the Johnston case, the way might be laid for review by the Supreme Court [fol. 50] on the basis of conflict with its decision and the decision of another Circuit.

The per curiam opinion fails to mention either one of these decisions.

III

The Constitutional Question

The Davis case is entirely different from the present case. That case dealt with a casual investor; taxpayer here was in the business of trading in securities. This difference appears both from a reading of the Davis opinion, which carefully leaves the field open for a case like the present, and from statements made from the bench in this and other cases. The per curiam opinion follows the Davis case without discussion. The taxpayer would seem entitled to be told why the Court has broadened the Davis case to cover this one, contrary to the opinion in that case.

IV

The taxpayer should be allowed to deduct 45% of the purchase commissions.

On this point the Court's opinion reaches an extremely harsh result. The taxpayer paid purchase commissions to his partnership; the partnership reported these commissions in its income; 45% of the commissions were distributed to petitioner and included by him in his taxable income.

The Court holds that, since the Supreme Court's decision in the Winmill case requires purchase commissions to be [fol. 51] capitalized, they are not deductible even though 45% of them is reflected in petitioner's income.

There is no authority for this view. The Winmill case did not deal with such a situation.

What happened in this case was no different from a transfer by an individual of money from his own bank account to a joint bank account. Would the Court sanction an income tax on such a transfer?

The Court says that the character of the capital expenditure is not changed by the fact that it was paid to taxpayer's partnership. Of course it was changed. It was changed, because to the extent of 45% it was paid back to taxpayer, and therefore to that extent was no longer a capital expenditure. To that extent, it was not an expenditure at all.

At least on this point, the taxpayer would seem entitled to relief from the startlingly unjust result arrived at by the Court.

Conclusion

Taxpayer should be given an opportunity to reargue the questions discussed above. To afford the taxpayer a basis for applying to the Supreme Court for certiorari, this Court should set forth its reasons for disregarding the 1938 Act, Jordan v. Roche and the Coulby case, and the grounds upon which the Davis case is here extended to a different situation.

[fol. 52] In any event, the taxpayer respectfully requests reconsideration of the decision as to the deductibility of the 45% of the purchase commissions paid by him and on which he has already been taxed.

Respectfully submitted,

Proskauer, Rose & Paskus, Counsel for Taxpayer.
Walter Mendelsohn, Wilbur H. Friedman, Martin Norr, of Counsel.

[fol. 53] CERTIFICATE OF COUNSEL

STATE OF NEW YORK,
County of New York, ss:

Walter Mendelsohn, being duly sworn, deposes and says:

I am a member of the firm of Proskauer, Rose & Paskus, counsel for petitioner herein, and am familiar with the facts of this case.

I hereby certify that the foregoing petition for a rehearing is not made for the purpose of delay. The petition is filed in

good faith in the belief that substantial ground for rehearing exists.

Walter Mendelsohn.

Sworn to before me this 22nd day of June, 1939. Marcia C. Morse, Notary Public. N. Y. Co. Clk's. No. 246, Reg. No. 0M346. My Commission expires March 30, 1940. (Seal.)

[fol. 54] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

HARRY H. NEUBERGER, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

vs.

HARRY H. NEUBERGER, Respondent

Before Swan, Chase and Patterson, Circuit Judges.

PETITION FOR REHEARING

Proskauer, Rose & Paskus, Attorneys for taxpayer; Walter Mendelsohn, Wilbur H. Friedman and Martin Norr, of counsel.

Per CURIAM:

The petition for rehearing is denied.

Jun. 28, 1939.

——, ——, C. J. J.

[fol. 55] UNITED STATES CIRCUIT COURT OF APPEALS, SECOND CIRCUIT

At a Stated Term of the United States Circuit Court of Appeals, in and for the Second Circuit, held at the United

States Courthouse in the City of New York, on the 28th day of June, one thousand nine hundred and thirty-nine.

Present: Hon. Thomas W. Swan, Hon. Harrie B. Chase, Hon. Robert P. Patterson, Circuit Judges.

HARRY H. NEUBERGER, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

vs.

HARRY H. NEUBERGER, Respondent

A petition for a rehearing having been filed herein by counsel for the taxpayer.

Upon consideration thereof, it is ordered that said petition be and hereby is denied.

Wm. Parkin, Clerk.

[fol. 56] [Endorsed:] United States Circuit Court of Appeals, Second Circuit. Harry H. Neuberger, vs. Commissioner of Internal Revenue. Order. United States Circuit Court of Appeals, Second Circuit. Filed Jun. 28, 1939. William Parkin, Clerk.

[fol. 57] UNITED STATES CIRCUIT COURT OF APPEALS, SECOND CIRCUIT

At a Stated Term of the United States Circuit Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 29th day of June, one thousand nine hundred and thirty-nine.

Present: Hon. Thomas W. Swan, Hon. Harrie B. Chase, Hon. Robert P. Patterson, Circuit Judges.

HARRY H. NEUBERGER, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

vs.

HARRY H. NEUBERGER, Respondent

Appeal from the United States Board of Tax Appeals.

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said United States Board of Tax Appeals be and it hereby is modified in accordance with the opinion of this court.

It is further ordered that a Mandate issue to the said Board in accordance with this decree.

Wm. Parkin, Clerk.

[fol. 58] [Endorsed:] United States Circuit Court of Appeals, Second Circuit. Harry H. Neuberger, vs. Commissioner of Internal Revenue (and cross appeal). Order for Mandate. United States Circuit Court of Appeals, Second Circuit. Filed Jun. 29, 1939. William Parkin, Clerk.

[fol. 59] UNITED STATES OF AMERICA, SOUTHERN DISTRICT OF NEW YORK

I, D. E. Roberts, Clerk of the United States Circuit Court of Appeals for the Second Circuit, do hereby certify that the foregoing pages, numbered from 1 to 58, inclusive, contain a true and complete transcript of the record and proceedings had in said Court, in the case of Harry H. Neuberger, Petitioner, vs. Commissioner of Internal Revenue, Respondent; Commissioner of Internal Revenue, Petitioner, vs. Harry H. Neuberger, Respondent, as the same remain of record and on file in my office.

In testimony whereof, I have caused the seal of the said Court to be hereunto affixed, at the City of New York, in the Southern District of New York, in the Second Circuit, this second day of November, in the year of our Lord one thousand nine hundred and thirty-nine, and of the Independence of the said United States the one hundred and sixty-fourth.

D. E. Roberts, Clerk. (Seal.)

[fol. 60] IN THE SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1939

No. —

HARRY H. NEUBERGER, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

ORDER EXTENDING TIME WITHIN WHICH TO APPLY FOR WRIT OF CERTIORARI

On consideration of the motion of counsel for petitioner in the above entitled case, and good cause therefor having been shown, it is now hereby ordered that the time within which a petition for a writ of certiorari may be filed herein be, and the same is hereby extended for a period of 60 days from this date.

Dated this 26th day of September, 1939.

Harlan F. Stone, Justice of the Supreme Court of the United States.

SUPREME COURT OF THE UNITED STATES

[Title omitted]

ORDER ALLOWING CERTIORARI—May 27, 1940

On Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit

A petition for rehearing having been submitted in this case;

Upon consideration thereof, it is ordered by this Court that the petition for rehearing be, and the same is hereby, granted.

And it is further ordered that the order denying certiorari entered January 2, 1940, be, and the same is hereby, vacated; and that the petition for writ of certiorari herein be, and the same is hereby, granted, limited to the second and third questions thereby presented.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

BLANK PAGE

FILE COPY

Office - Supreme Court, U. S.
FILED
NOV 21 1939
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1939.

No. [redacted] 5

HARRY H. NEUBERGER,

Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

JOSEPH M. PROSKAUER,
WALTER MENDELSOHN,
WILBUR H. FRIEDMAN,
Attorneys for Petitioner.

November, 1939.

THE COURT PRESS, N. Y. C.

INDEX.

	PAGE
Opinions Below	1
Jurisdiction	1
Questions Presented	2
Statement	3
Statutes and Regulations Involved	5
Assignments of Error	6
Reasons for Granting the Writ	7
I. The case presents important questions of Federal tax law which have not been, but should be, decided by this Court	7
II. The decision below erroneously interprets this Court's decision in *Helvering* v. *Winmill*, 305 U. S. 79	9
III. The decision below conflicts with that of the Sixth Circuit in *United States* v. *Coulby*, 258 Fed. 27	10
IV. The decision below conflicts with the decision of this Court in *Jordan* v. *Roche*, 228 U. S. 436	12
V. The case presents an important question of constitutional law which has not been, but should be, decided by this Court	14
Conclusion	15

TABLE OF CASES CITED:

Anderson v. *Newhall*, 161 Fed. 906	13
Davis v. *United States*, 87 F. (2d) 323	15
Doyle v. *Commissioner*, 102 F. (2d) 86 (C. C. A. 4th)	8

PAGE

Helvering v. *Smith*, 90 F. (2d) 590 (C. C. A. 2d)..... 8
Helvering v. *Walbridge*, 70 F. (2d) 683 (C. C. A. 2d) 8
Helvering v. *Winmill*, 305 U. S. 79.....2, 5, 9
D. T. Humphrey, 32 B. T. A. 280..... 8

Zelda B. Jennings, et al., B. T. A. Memo., July 25, 1939, Docket No. 94529..... 8
Johnston v. *Commissioner*, 86 F. (2d) 732....10, 11, 12, 13
Jordan v. *Roche*, 228 U. S. 436.....12, 13, 14

Rossmoore v. *Commissioner*, 76 F. (2d) 520 (C. C. A. 2d)..... 8

United States v. *Coulby*, 251 Fed. 982, 258 Fed. 27 (C. C. A. 6th).....8, 10, 11, 12, 14

OTHER AUTHORITIES CITED:

Judicial Code, as amended by the Act of February 13, 1925:
Section 240(a)..... 2

Revenue Act of 1932:
Section 23(r) 2, 5, 6
Section 23(t) 5

Revenue Act of 1938:
Section 182 .....5, 12

G. C. M. 10092, XI-1 C. B. 114..... 8
G. C. M. 18120, 1937-1 C. B. 151..... 8
G. C. M. 20251, 1938-2 C. B. 169..... 8
G. C. M. 21478, 1939 I. R. B. 35-9980..... 8

House Report No. 1860, 75th Cong., 3rd Sess., pp. 42-43 12

Senate Report No. 1567, 75th Cong., 3rd Sess., p. 22.. 12

IN THE

Supreme Court of the United States

OCTOBER TERM, 1939.

No.

HARRY H. NEUBERGER,

Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Petitioner respectfully prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Second Circuit entered on June 12, 1939 (R. 46) modifying an order of the Board of Tax Appeals involving petitioner's 1932 income tax.

Opinions Below.

The opinion of the Board of Tax Appeals (R. 20-23) is reported in 37 B. T. A. 223. The opinion of the Circuit Court of Appeals (R. 46-47) is reported in 104 F. (2d) 649.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on June 12, 1939 (R. 46). Petition for re-

hearing was denied on June 28, 1939 (R. 52). An order granting an extension of 60 days to file the petition for certiorari was signed on September 26, 1939 (R. 54).

The jurisdiction of this Court is invoked under §240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Questions Presented.

(1) In 1932 petitioner, engaged in the business of trading in securities, paid commissions on the purchase of securities to his Stock Exchange partnership, a portion of which commissions were returned to him in 1932 as part of his distributive and taxable share of the partnership income. Does *Helvering* v. *Winmill,* 305 U. S. 79, require the disallowance as a deduction from taxable income of such repaid portion of the commissions?

(2) Whether, under §23(r) of the Revenue Act of 1932, petitioner, engaged in the business of trading in securities, may offset losses on the sale of non-capital securities owned by him as an individual, against profits from the sale of non-capital securities owned by him and another as partners.

(3) Whether, if construed to deny such offset, §23(r) of the Revenue Act of 1932 is constitutional, as applied in this case, where petitioner's business activities in trading for his own account and for the account of the partnership against whose profits he seeks to offset his losses, were interwoven in one continuous course of business.

Statement.

The facts were stipulated (R. 12-14). From them the Board found (R. 20-22):

> The petitioner, an individual, resident of New York, New York, was a member of the New York Stock Exchange. He was engaged in the business of trading in securities on the floor of the Exchange for the partnership of Hilson & Neuberger, of which he was a member, executing orders on behalf of customers of the partnership and for his individual account.
>
> During the taxable year the petitioner sustained a net loss, from his individual trading, from sales or exchanges of stocks and bonds which were not capital assets (as defined in section 101 of the Revenue Act of 1932), in the aggregate sum of $25,588.93. In computing such loss he deducted stock transfer taxes and commissions on sales of securities from the selling price and he added commissions paid upon the purchases of securities to the cost and treated them as a part of the cost of securities sold. Federal and New York stock transfer taxes on such sales amounted to $2,779.69. Commissions paid during the year upon purchases and sales, respectively, were $2,133.63 and $2,306.98. These taxes and commissions—the latter having been paid to the aforesaid firm of Hilson & Neuberger and reported by it for income tax purposes in its return for that year—were not separately deducted in the petitioner's return for 1932.
>
> The petitioner's firm derived a profit of $142,802.29 in the taxable year from the sale of

> stocks and other securities which were not capital assets of the type hereinbefore indicated. It had other income (including commissions received) of $170,830.65 and deductions of $203,981.78, or a net income of $109,651.06[.16]. The petitioner's distributive share of said profits amounted to $36,000 of the first $94,000 and 45 percent of the remainder.

Paragraph 7 of the stipulation of facts (R. 14) reads in part:

> During the year 1932, petitioner was a member of the New York Stock Exchange, and spent practically every working day of the year 1932 on the floor of the Exchange, trading for the account of his firm (Hilson & Neuberger), executing orders on behalf of customers of said firm, and trading for his individual account.

The Commissioner determined a deficiency in income tax for the year 1932 arising mainly from the disallowance of petitioner's individual losses on his non-capital securities as an offset against the partnership's similar gains. The Board upheld the Commissioner on this issue, but held that, as petitioner was engaged in the business of trading in securities, he was entitled to deduct purchase and sales commissions paid in connection with his security trading business (R. 22-23).

Before the case was heard in the Court below, Congress stated its disapproval of the rule followed by the Board on the security loss issue, and in the Revenue Act of 1938 provided that individual and partnership security profits and losses could be offset

against each other. Section 182 of the Revenue Act of 1938, *infra*, page 12.

This change was fully presented to the Court below, but in a *per curiam* opinion that Court affirmed the Board on this point, and with respect to the commissions, it modified the Board's decision, following *Helvering* v. *Winmill*, 305 U. S. 79, by eliminating in full the deduction for purchase commissions (R. 47). The Court gave no weight to the distinguishing feature that here part of the purchase commissions were repaid to petitioner in the same taxable year and that such repaid part was included in his taxable income. A petition for rehearing (R. 48-51) was denied without opinion (R. 52).

Statutes and Regulations Involved.

Sections 23(r)(1) and 23(t) of the Revenue Act of 1932 provided as follows:

> (r) Limitation on Stock Losses.—
>
> (1) Losses from sales or exchanges of stocks and bonds (as defined in subsection (t) of this section) which are not capital assets (as defined in section 101) shall be allowed only to the extent of the gains from such sales or exchanges * * *.
>
> (t) Definition of Stocks and Bonds.—
>
> As used in subsections (r) and (s), the term "stocks and bonds" means (1) shares of stock in any corporation, or (2) rights to subscribe for or to receive such shares, or (3) bonds, debentures, notes, or certificates or other evidences of indebtedness, issued by any corporation (other than a government or political subdivision there-

of), with interest coupons or in registered form, or (4) certificates of profit, or of interest in property or accumulations, in any investment trust or similar organization holding or dealing in any of the instruments mentioned or described in this subsection, regardless of whether or not such investment trust or similar organization constitutes a corporation within the meaning of this Act.

Assignments of Error.

(1) The Court below erred in holding that petitioner, engaged in the business of trading in securities, could not deduct purchase commissions paid by him to his partnership to the extent that the commissions were returned to him in the same taxable year as part of his distributive and taxable share of the partnership's income.

(2) The Court below erred in holding that petitioner, who was in the business of trading in securities, could not offset losses from the sale of non-capital securities owned by him individually against profits from the sale of similar securities owned by him and another as partners.

(3) The Court below erred in holding that §23(r) of the Revenue Act of 1932, construed to prevent such an offset, was constitutional as applied to a case where the taxpayer's business activities in trading for his own account and for the account of the partnership against whose profits he seeks to offset his losses were interwoven into one continuous course of business. Construed as it was by the Court below in this case, §23(r) is so unreasonable and arbitrary as to violate the due process clause of the Fifth Amendment.

Reasons for Granting the Writ.

I.

The case presents important questions of Federal tax law which have not been, but should be, decided by this Court.

Sooner or later this Court will find it necessary to pass on the question whether partnership income retains its identity in the hands of the individual partners for income tax purposes, or loses such identity and becomes general income. This case presents two different aspects of this question. Other cases are now pending in the courts and the Bureau of Internal Revenue involving the same problem. Different phases of the problem have been frequently presented to the Bureau, the Board of Tax Appeals, and the courts, and will continue to be until this Court finally resolves the point. The views thus far expressed have been by no means unanimous **and Congress itself has indicated its disagreement with the view taken by the Bureau and the Court below in this case.**

The phases of the question presented in this case are:

(1) Whether commissions paid by a partner to his partnership retain their identity as commissions when distributed to the same partner. This question is pending in at least one Court of Claims case.

(2) Whether partnership security profits retain their identity as security profits in the hands of the partners. This question was presented in dozens of cases, some still pending. Congress has stated its disagreement with the view of the court below.

Other phases of the same question are:

(3) Whether interest paid by a partner to his partnership retains its identity as interest when distributed to the same partner. This question is pending in at least one Court of Claims case.

(4) Whether partnership dividend income retains its identity in the hands of the partner. This was the issue in *United States* v. *Coulby,* 258 Fed. 27 (C. C. A. 6th) discussed at length below, and believed to be in conflict with the decision of the Court below.

(5) Whether partnership wagering income retains its identity in the hands of the partner. This was the issue in *Zelda B. Jennings et al.,* B. T. A. Memo., July 25, 1939, Docket No. 94529; also in G. C. M. 21478, 1939 I. R. B. 35-9980.

(6) Whether tax-free covenant bond interest retains its identity in the hands of the partner. This was the question in G. C. M. 18120, 1937-1 C. B. 151.

(7) Whether partners are vested before distribution with an interest in specific firm property as coowners. This question comes up in connection with basis of partnership assets (*Helvering* v. *Walbridge,* 70 F. (2d) 683 (C. C. A. 2d), where the court below overruled G. C. M. 10092, XI-1 C. B. 114, in part); holding period of partnership assets distributed to partners (G. C. M. 20251, 1938-2 C. B. 169); whether an interest in a partnership is a capital asset or merely an interest in partnership income and assets (*Doyle* v. *Commissioner,* 102 F. (2d) 86 (C. C. A. 4th), *Rossmoore* v. *Commissioner,* 76 F. (2d) 520 (C. C. A. 2d), and *Helvering* v. *Smith,* 90 F. (2d) 590 (C. C. A. 2d) all of which appear to be in conflict with the decision below; *contra, D. T. Humphrey,* 32 B. T. A. 280).

II.

The decision below erroneously interprets this Court's decision in *Helvering* v. *Winmill*, 305 U. S. 79.

In the *Winmill* case this Court held that commissions paid upon the purchase of securities are not deductible from income but must be added to the cost of the securities. The Court below purported to follow the *Winmill* case, although here the commissions were paid by petitioner to his partnership and 45% of them were rebated to him and included in his income as part of his distributive share of the firm income. The Court below said that this fact "does not change their character as capital expenditures by the taxpayer. *To conform to the ruling of the Supreme Court,* the deduction of commissions on purchases must be disallowed." (Italics ours.)

There is not a word in the *Winmill* case to justify this extreme result. In that case, the commissions were disallowed as deductions and treated as part of the cost of the securities, although such action merely increased the loss on the sale of securities which the Court below had held to be non-deductible, with the result that the taxpayer was entirely deprived of the commissions as a deduction. Here the Court goes one step further and sanctions the taxation of petitioner upon the transfer of a non-deductible capital expenditure from himself to his partnership and back again without any accretion in his total wealth. The Court below erred in holding that this Court's decision required disallowance of the part of the purchase commissions which was rebated to him and included in his taxable income for the same year.

If this result is sought to be sustained on the theory that the commissions lost their identity as such, then the decision below conflicts with *United States* v. *Coulby,* 258 Fed. 27 (C. C. A. 6th), discussed in the next point.

III.

The decision below conflicts with that of the Sixth Circuit in *United States* v. *Coulby,* 258 Fed. 27.

On the issue whether petitioner's security losses could be offset against his share of the partnership's security profits, the Court below followed its earlier decision in *Johnston* v. *Commissioner,* 86 F. (2d) 732, Swan, *C. J.* dissenting. The basis of the holding was stated thus at page 734 of the *Johnston* case:

> "* * * when the partnership return shows net income a partner's distributive share is to be entered in his own return as his own income derived from the partnership without retaining the peculiar character it had in the partnership return unless Congress has expressly so provided and then only for the purpose stated."

In *United States* v. *Coulby,* 258 Fed. 27 (C. C. A. 6th), the question was whether dividends received by a partnership should be treated as dividends in the hands of the individual partners, and therefore exempt from normal tax, or whether, as contended by the Government, dividends received by the partnership should be fully taxable in the partner's hands because

they had lost their identity as such. There was no provision in the law covering the point.

The Court held for the taxpayer, holding that the dividends received by the partnership retained their identity as dividends in the hands of the partners. The basis of the holding was stated thus (251 Fed. 982 at 984):

> "The law is so framed as to deal with the gains and profits of a partnership as if they were the gains and profits of the individual partner. * * * The law looks through the fiction of a partnership and treats its profits and its earnings as those of the individual taxpayer. Unlike a corporation, a partnership has no legal existence aside from the members who compose it. The Congress, consequently, it would seem, ignored, for taxing purposes, a partnership's existence, *and placed the individual partner's share in its gains and profits on the same footing as if his income had been received directly by him without the intervention of a partnership name.*" (Italics ours.)

We challenge the Government to reconcile the conflicting points of view expressed by the Second Circuit in the *Johnston* case and by the Sixth Circuit in the *Coulby* case. None of the courts which have considered the instant question have discussed the *Coulby* case, although we asked the Court below to do so both in main argument and petition for rehearing (R. 49).

The conflict between the decision below and the *Coulby* case is all the more marked because both in

that case and in this Congress approved the taxpayer's view in a later Act. The Sixth Circuit said the later Act confirmed its interpretation of the partnership tax provisions (258 Fed. at 28; 251 Fed. at 985); the Court below did not see fit to discuss the 1938 Act (see petition for rehearing at R. 48).

IV.

The decision below conflicts with the decision of this Court in *Jordan* v. *Roche*, 228 U. S. 436.

The first general Revenue Act following the decision of the Court below in the *Johnston* case was the 1938 Act, in §182 of which[1] Congress expressly provided that security transactions of the partnership are to be carried over to the individual partner's returns as such. The Ways and Means Committee said that §182 was "a logical corollary of the principle that only the partners as individuals, not the partnership as an entity, are taxable persons * * *."[2]

---

[1] "Sec. 182—Tax of Partners.

In computing the net income of each partner, he shall include, whether or not distribution is made to him——

(a) As a part of his short-term capital gains or losses, his distributive share of the net short-term capital gain or loss of the partnership.

(b) As a part of his long-term capital gains or losses, his distributive share of the net long-term capital gain or loss of the partnership.

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in Section 183(b)."

[2] 75th Cong., 3rd. Sess., H. Rept. 1860, pp. 42-43. The Senate took the same view. 75th Cong., 3rd. Sess., S. Rept. 1567, p. 22.

As this corollary was no more logical in 1938 than in 1932 (the Act here in question), it is obvious that only the *Johnston* case made it necessary to put the corollary into the statute. (See the dissenting opinion of Swan, *C. J.*, 86 F. (2d) at 735, pointing out that prior to the 1932 Act, partnership security transactions retained their identity as such on the partner's returns and that the 1932 Act made no change in the partnership sections.)

Thus the situation is the same as faced this Court in *Jordan* v. *Roche,* 228 U. S. 436. There the question was the taxation, under the general provisions of an Act of 1900, of Porto Rico bay rum. In 1908, the Court below held the product exempt from tax. *Anderson* v. *Newhall,* 161 Fed. 906.

In 1909, Congress passed a statute specifically providing that Porto Rico bay rum was taxable. Then the *Jordan* case involving the 1900 statute came before this Court. It was contended that the 1909 statute was a declaration by Congress that the product was not taxable under the 1900 Act. This Court dismissed the contention as follows (228 U. S. at 445-6):

> "On February 4, 1909, Congress passed the act by which it is provided 'that upon bay rum, * * * hereafter brought from Porto Rico into the United States for consumption or sale, there shall be paid a tax of one dollar and ten cents per proof gallon,' * * *. It is insisted that this act is a declaration by Congress that bay rum was not subject to a tax under prior statutes. The history of the act rejects the contention and manifests that the act was passed in consequence of the decision in *Anderson* v. *Newhall,* and the

other decisions to which we have referred. The law was not the declaration of a new policy, but a more explicit expression of the purpose of the prior law, made necessary by the judicial construction of that law."

It will be noted that this is the same view expressed by the Sixth Circuit in the *Coulby* case discussing the provisions of a later Revenue Act with respect to the precise question now presented as to the nature of partnership income in the hands of the partners.

If the Government contends that the 1938 Act, as it affects the instant problem, represents a change in the partnership tax law, thus differing from the later Acts discussed in *Jordan* v. *Roche* and *United States* v. *Coulby*, then we challenge the Government to state when and where Congress enunciated a change in the principle, applied in the *Coulby* case, that partnership income retains its identity in the partner's hands.

V.

The case presents an important question of constitutional law which has not been, but should be, decided by this Court.

The constitutional question is whether, in the case of a man whose business has two phases, one profitable and one losing, Congress may tax him on the profits without allowing deduction for the losses. There is no decision of this or any other court on the point.

The petitioner was in the business of trading in securities on the floor of the Stock Exchange (R. 14,

20-21, 23). He traded for himself and for his partnership. His trading for the partnership was profitable; his own trading showed a loss. The Commissioner taxed him on the profits and disallowed the losses as a deduction. In answer to the argument that this is so unreasonable and arbitrary as to violate the due process clause of the Fifth Amendment, the Court below (R. 47) cited its own decision in *Davis* v. *United States,* 87 F. (2d) 323.

The *Davis* case is as different as day from night. Davis was a casual investor seeking to deduct security losses from his ordinary salary and other income. He was not in the business of trading in securities. The basis of the decision, repeatedly stated in the opinion, was that Congress could constitutionally deny deduction of casual security losses which were unrelated to the taxpayer's ordinary income. But Neuberger's losses arose out of the very business which was his main source of income—trading in securities on the floor of the Stock Exchange.

Constitutional questions are questions of degree. It shocks one's sense of fairness for Congress to divide up petitioner's business activity arbitrarily, taxing him on the profitable phase without deduction for the losing phase. No case goes so far in splitting a single course of business conduct for tax purposes.

Conclusion.

This is an extraordinary case. Petitioner was in the security trading business. The net result was a profit which he reported and on which he paid a tax. The Commissioner threw out the unprofitable business

transactions and increased the tax. The Court below upheld the Commissioner although there was nothing in the 1932 Act requiring it to do so and although, before it decided the case, Congress had stated its disagreement with the Commissioner's view. And then the Court went further—it taxed petitioner on a part of the unprofitable transactions, the security purchase commissions he had paid to the partnership and which were reflected in his distributive share of the firm income.

The case involves important questions of Federal tax and constitutional law which have not been but should be decided by this Court. The decision below is wrong, and conflicts with decisions of this Court and of the Sixth Circuit. The petition for certiorari should be granted.

Respectfully submitted,

JOSEPH M. PROSKAUER,
WALTER MENDELSOHN,
WILBUR H. FRIEDMAN,
Attorneys for Petitioner.

November, 1939.

FILE COPY

Office - Supreme Court, U. S.
FILED
DEC 15 1939
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1939.

No. [redacted] 5

HARRY H. NEUBERGER,

Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

REPLY BRIEF.

JOSEPH M. PROSKAUER,
WALTER MENDELSOHN,
WILBUR H. FRIEDMAN,
Attorneys for Petitioner.

December, 1939.

THE COURT PRESS, N. Y. C.

INDEX.

PAGE

I. Importance of the Question of Statutory Interpretation 1

II. Conflict With the *Coulby* Case..... 3

III. Conflict With *Jordan* v. *Roche*, 228 U. S. 436... 5

IV. The Constitutional Question..... 6

V. The Commission Question..... 7

Conclusion 8

TABLE OF CASES CITED:

Davis v. *United States*, 87 F. (2d) 323..... 6, 7

Helvering v. *Johnson*, 104 F. (2d) 140 (C. C. A. 8th), certiorari granted October 9, 1939..... 2

Helvering v. *Winmill*, 305 U. S. 79..... 8

Johnston v. *Commissioner*, 86 F. (2d) 732 (C. C. A. 2d) 4, 5, 6, 7

Jordan v. *Roche*, 228 U. S. 436..... 5, 6

Klingenstein v. *United States*, 18 F. Supp. 1015..... 6, 7

Smith v. *Higgins*, 102 F. (2d) 456 (C. C. A. 2d), certiorari granted October 9, 1939..... 2

United States v. *Coulby*, 251 Fed. 982, 258 Fed. 27 (C. C. A. 6th).....3, 4, 5, 6, 7

OTHER AUTHORITIES CITED:

House Report No. 1860, 75th Cong., 3rd Sess., pp. 42-43 6

Revenue Act of 1934
Section 24(a)(6) 2

Revenue Act of 1938..... 1

IN THE

Supreme Court of the United States

OCTOBER TERM, 1939.

No. 548.

HARRY H. NEUBERGER,

Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

REPLY BRIEF.

The brief in opposition treats matters of importance in a manner so cavalier as to require a short reply.

I.

Importance of the question of statutory interpretation.

The Government says that the question of statutory interpretation is not important because covered for 1938 and subsequent years by the Revenue Act of 1938.

The year in question is 1932. It is not denied that the question in this case arises for the six tax years 1932 to 1937 inclusive. It is not denied that the question in this case was presented in dozens of cases, some

still pending. It is not denied that the basic issue in the case, whether partnership income retains its identity in the hands of the partner, arises in at least seven different ways, and that cases involving the general problem are now pending and will continue to arise, and that on most of these points the statute is still silent. (See Petition for Certiorari, pp. 7, 8.)

When the Government applies for certiorari on a question covered by a later Revenue Act, it sings a different tune. It is not deterred from claiming that the question is important by reason of the fact that the specific issue has been covered by a later statute.

In *Smith* v. *Higgins,* 102 F. (2d) 456 (C. C. A. 2d), certiorari granted October 9, 1939, and in *Helvering* v. *Johnson,* 104 F. (2d) 140 (C. C. A. 8th), certiorari granted October 9, 1939, the issue was whether an individual realized a deductible loss upon the sale of securities to a corporation controlled by him. The tax year 1932 was involved in both cases. Section 24(a)(6) of the Revenue Act of 1934 provided that such loss was not allowable. Hence, at the time the Government filed the petitions for certiorari in 1939, the question was covered by the Act and could still arise only with respect to tax years earlier than 1933.

This is what the Government said about the 1934 Act in its petition for certiorari in the *Smith* case (p. 19):

> "The 1934 amendment does not demonstrate that the case at bar is unimportant. * * * It may also be noted that this Court has granted a writ of certiorari to resolve a conflict of circuits notwithstanding the repeal of the statute involved and although no similar case was pending or could arise."

The taxpayer strenuously contended that the 1934 amendment made the question academic, but certiorari was granted.

II.

Conflict With the *Coulby* Case.

The Government says that the decision below was not in conflict with the *Coulby* case because the decision in the latter case "was based squarely on the Court's interpretation of the specific provisions of the 1913 Act" (Br. in Opp., p. 5, footnote). This is an amazing statement.

If there was a specific provision in the 1913 Act covering the issue in the *Coulby* case, why does not the Government cite it? There was no such provision. In fact, in the *Coulby* case, the Government argued that since the 1916 Act did contain a specific provision with respect to the deductibility by a partner of his share of the partnership dividend income, the 1913 Act should be construed not to allow such deduction.

The question in the *Coulby* case arose precisely because there was no specific provision in the 1913 Act on the dividend question there at issue. In this respect, the case presented exactly the same problem as this case, and the Court there dealt with the question before it by applying the general rule that partnership income retains its identity in the hands of the partners. This is the rule which petitioner now seeks to have this Court apply here.

In order that the Court may determine whether the *Coulby* case and the decision below are in con-

flict, we print below in parallel columns the basis of decision in the *Coulby* case (251 Fed. at 984) and in the *Johnston* case (86 F. (2d) at 734):

Coulby	*Johnston*
"The law is so framed as to deal with the gains and profits of a partnership as if they were the gains and profits of the individual partner. * * * The law looks through the fiction of a partnership and treats its profits and its earnings as those of the individual taxpayer. Unlike a corporation, a partnership has no legal existence aside from the members who compose it. The Congress, consequently, it would seem, ignored, for taxing purposes, a partnership's existence, *and placed the individual partner's share in its gains and profits on the same footing as if his income had been received directly by him without the intervention of a partnership name.*" (Italics ours.)	"* * * when the partnership return shows net income, a partner's distributive share is to be entered in his own return as his own income derived from the partnership without retaining the peculiar character it had in the partnership return unless Congress has expressly so provided and then only for the purpose stated."

In the *Coulby* case there was no specific provision dealing with the deductibility by a partner of his share of the partnership's dividend income. In this

case, there is no specific provision dealing with the deductibility by a partner of individual security losses against partnership security profits. In both cases, the law provided that partnerships as such paid no tax and that the individual partners reported their shares of the partnership income.

Accordingly, both Courts were compelled to and did approach the question from the point of view of the general nature of partnership income. The Sixth Circuit decided that the partnership income retained its identity in the partners' hands. The Second Circuit decided that the partnership income did not retain its identity in the partners' hands.

III.

Conflict With *Jordan v. Roche*, 228 U. S. 436.

The Government denies this conflict on the ground that, in the *Jordan* case, the legislative history showed that the particular amendment involved was intended as an explicit provision of the purpose of the prior law, and says: "There is no comparable legislative history here and petitioner points to no reason why, under the circumstances of the present case, the usual inference should not be drawn" [that the later statute changes the former] (Br. in Opp., p. 7).

We assert that there is comparable legislative history here and offer the following reasons why, in this case, the later statute shows the intention of the prior:

1. Between 1918, when the *Coulby* case was decided, and 1936, when the *Johnston* case was decided by the Court below, it was uniformly held that part-

nership income retained its identity in the hands of the partner. This was referred to by Judge Swan in his dissenting opinion in the *Johnston* case (86 F. (2d) at 735).

2. There never has been any provision in the Tax Law denying to an individual partner the right to offset his individual security losses against his share of partnership security profits. The first enactment on the subject was §182 of the 1938 Act, which allowed the deduction. This provision was included in the first general Revenue Act after the *Johnston* case in order to make it clear that Congress disapproved that case.

3. In covering the instant point in the 1938 Act, the Ways and Means Committee said that the new provision was "a logical corollary of the principle that only the partners as individuals, not the partnership as an entity, are taxable persons" (see Petition for Certiorari, p. 12). As this corollary was no more logical in 1938 than in 1932, the present situation is clearly one where, as the Courts held in *Jordan* v. *Roche* and in the *Coulby* case, the specific language of the later statute is indicative of the intention of the earlier. In the *Coulby* case such later statute, as in this case, dealt specifically with the nature of partnership income in the partners' hands for tax purposes.

IV.

The Constitutional Question.

The Government states that the constitutional issue has been decided against petitioner in cases in which this Court has denied petitions for certiorari. It cites the *Johnston, Davis* and *Klingenstein* cases.

In the *Johnston* case, the constitutional question was not raised in the Circuit Court of Appeals nor presented by the petition for certiorari. The *Davis* case involved a casual investor, not a trader in securities. In the *Klingenstein* case the constitutional question was not presented to the Court of Claims nor raised in the petition for certiorari in this Court. In none of these cases was the taxpayer engaged in the business of trading in securities, as he is in this case.

There has never been a case which disallowed to a person engaged in business deductions for losses sustained in the conduct of that business. The Government's statement to the contrary is unwarranted and certainly not justified by the cases it cites.

V.

The Commission Question.

The Government says that on this issue there is no conflict with the decision of any other Circuit Court of Appeals (Br. in Opp., p. 7).

The commission issue involves the question whether commissions paid by petitioner to his partnership retained their identity as commissions when repaid to him. In holding in effect that they do not, the decision of the Court below is in conflict with the decision in the *Coulby* case, where partnership income was held to retain its identity in the partners' hands. Further, as to this issue, it is not open to the Government to claim that the question is controlled by a later statute, as there is none on this point.

In any event, petitioner submits that there is nothing in the *Winmill* case to support the arbitrary and unjust result reached below with respect to the portion of the purchase commissions repaid to taxpayer by his partnership.

CONCLUSION.

For the reasons set forth in the petition for certiorari, some of which are restated herein, the petition should be granted.

Respectfully submitted,

JOSEPH M. PROSKAUER,
WALTER MENDELSOHN,
WILBUR H. FRIEDMAN,
Attorneys for Petitioner

December, 1939.

FILE COPY

No. 5

Office - Supreme Court, U. S.
FILED
SEP 24 1940
CHARLES ELMORE CROPLEY
CLERK

Supreme Court of the United States

HARRY H. NEUBERGER,

Petitioner,

—*vs.*—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR PETITIONER

WALTER MENDELSOHN
WILBUR H. FRIEDMAN
JACOB P. ARONSON

September, 1940.

New York Appeals Co. Inc. 38 Ferry St.

INDEX

PAGE

Opinions Below 1

Jurisdiction 1

Questions Presented 2

Statutes Involved 2

Statement 2

Specification of Errors To Be Urged 4

Summary of Argument 5

Point I. Under the Revenue Act of 1932, petitioner, engaged in the single business of trading in securities on his own account and as a member of a partnership, may offset his individual losses from the sale of non-capital securities against his share of partnership gains from the sale of non-capital securities 8

The Origin of the Principle that Items of Partnership Income Retain on Partners' Returns the Same Character They Had on the Partnership Return 11

Statutory and Administrative Applications of the General Rule that Items of Partnership Income Retain the Same Character on Partners' Returns as They Had on the Partnership Return 17

The General Rule that Items of Partnership Income Retain the Same Character on Partners' Returns as They Had on the Partnership Return Was Carried Over Into the 1932 Act .. 23

PAGE

Petitioner's Interpretation of the 1932 Act Is Confirmed by Section 218(d) of the National Industrial Recovery Act 27

Congress Has Indicated Its Disapproval of the Failure of the Treasury and the Court Below to Apply to Security Profits the General Rule that Items of Partnership Income Retain the Same Character on Partners' Returns as They Had on the Partnership Return 29

A Majority of the Federal Courts Passing on the Question Have Held that Items of Partnership Income Retain on Partners' Returns the Same Character They Had on the Partnership Return 34

Point II. Section 23 (r) of the Revenue Act of 1932 is unconstitutional if construed to deny to petitioner offset of his non-capital security losses against his distributive share of partnership non-capital security gains, petitioner being engaged in the business of trading in securities for his own account and for his partnership 41

Discrimination Against Petitioner Because His Profits Were Realized in Partnership Is Unconstitutional 43

Discrimination Against Petitioner Because His Business Was Trading in Corporate Securities Is Unconstitutional 45

Conclusion 49

Appendix 51

Statutes Involved 51

TABLE OF CASES CITED

PAGE

Barclay & Co. v. Edwards, 267 U. S. 442, 450 ..... 41n
Brushaber v. Union Pacific R. R., 240 U. S. 1, 24 ..... 41n

Charles J. Bradley, 41 B. T. A. 153 47
Cohn v. United States, 23 F. Supp. 534 ..... 42n
Craik v. United States, 31 F. Supp. 132 ....15, 16, 23, 23n, 34, 36, 37, 38, 39, 40, 45

Davis v. United States, 87 F. (2d) 323, cert. denied 301 U. S. 704 .....4, 42, 43, 45
Denman v. Slayton, 282 U. S. 514, 520 ..... 41n

Edward B. Archbald, 27 B. T. A. 837 (1933) affd. 70 F. (2d) 720, cert. den. 293 U. S. 594 .....23n, 24n

Helvering v. City Bank Farmers Trust Co., 296 U. S. 85, 90 44
Helvering v. Clifford, 309 U. S. 331 10
Helvering v. Hallock, 309 U. S. 106 10
Helvering v. New York Trust Co., 292 U. S. 455 34

Jennings v. Commissioner, 110 F. (2d) 945 .... 15n, 34, 35
Johnston v. Commissioner, 86 F. (2d) 732, cert. den. 301 U. S. 683 .....3, 4, 28, 29, 31, 34, 35, 36, 38, 40
~~Johnston v. United States, 86 F. (2d) 732 ..... 7~~
Jordan v. Roche, 228 U. S. 436 34

Klingenstein v. United States, 18 F. Supp. 1015 .....34, 40

Leo Schwartz v. Commissioner, 7 B. T. A. 223 ..... 19n
Lord Forres, 25 B. T. A. 154 (1932) 23n

Mosbacher v. United States, 30 F. Supp. 703 ..... 34n

PAGE

Percy H. Johnston, 34 B. T. A. 276 (1936) affd. 86 F. (2d) 732, cert. den. 301 U. S. 683 ..... 23n

Reinecke v. Smith, 289 U. S. 172, 177 ..... 41n

United States v. Coulby, 258 Fed. 27, affirming 251 Fed. 982 .....5, 6, 13, 14, 15, 22, 24n, 30, 33, 34, 35, 40

Winmill v. Commissioner, 93 F. (2d) 494 reversed on another point 305 U. S. 79 .....34n, 42n

W. J. Burns, 12 B. T. A. 1209 (1928) 23n

STATUTES AND OTHER AUTHORITIES CITED

Article 30 (par. 213) of Regulations 33 (Rev. Ed. 1918) 13

A. R. M. 13, 2 C. B. 168 (1920) 14n

A. R. R. 2859, II-2 C. B. 159, 162 (1923) 14n

Art. 261(e) Reg. 74, 1928 Act 18n

Art. 89(b) Reg. 74, 1928 Act 19

Art. 88(b) Reg. 77, 1932 Act 19

Cotton Futures Act (1914), 38 Stat. 693, 26 U. S. C. A. §1920 48

Fifth Amendment of the United States Constitution 4, 41, 50

G. C. M. 13771, XIII-2 C. B. 229, 230 (1934) ..10n, 14n, 22, 30, 40

G. C. M. 21418 1939-2 C. B. 249, 250 (1939) 10n

G. C. M. 21478, 1939 CCH, par. 6455 ..... 15n

G. C. M. 21478, 1939-2 C. B. 159; B. T. A. Memo. Docket No. 94529, July 25, 1939 35

G. C. M. 2467, VII-2 C. B. 188, 192 (1928) 14n

G. C. M. 18120, 1937-1 C. B. 151 (1937) 21

G. C. M. 17255, XV-2 C. B. 243 ..... 22n

G. C. M. 14012, XIV-1 C. B. 145 (1935) 29, 31, 34

PAGE

I. T. 1576, II-1 C. B. 144 (1923) 14n
I. T. 2672, XII-1 C. B. 72, 73 46
I. T. 2671, XII-1 C. B. 41 46
I. T. 2671, XII-1 C. B. 41, 43 46
I. T. 2774, XIII-1 C. B. 62 46
I. T. 2671, XII-1 C. B. 41, 43 46

Montgomery, Income Tax Procedure, 1917 Ed., p. 108 .. 12n

National Industrial Recovery Act, Section 218(a) ..24n, 27, 28, 29, 33, 36

O. 972, 2 C. B. 163, 165 (1920) 14n

Regs. 77, 1932 Act 18n
Reg. 103. Sec. 19.22(b)(4)-5(b) 20
Report of House Ways and Means Committee (73rd Cong., 2d Sess., H. Rept. 704, p. 18) 28n
Report of House Ways and Means Committee (75th Cong., 3rd Sess., H. Rept. 1860, pp. 42-43) 32
Report of Senate Finance Committee (72nd Cong., 1st Sess., S. Rept. 665 p. 10) 25
Report of Senate Finance Committee (73rd Cong., 1st Sess., S. Rept. 114, p. 7) 27, 28n
Report of Ways and Means Committee (72nd Cong., 1st Sess., H. Rept. 708, pp. 12, 13) 25, 47
Revenue Act of 1932
Section 23(r) 2, 3, 4, 5, 6, 7, 8, 9, 16, 24, 25, 27, 29, 35, 40, 41, 42, 44, 45, 47, 48, 49, 50
Section 101 .....2n, 3, 32n
Supplement F 9, 17, 18, 19, 20, 24, 27, 35
Section 22(b)(4) 19
Section 182 .....31, 32
Section 23(e)(1) 49
Section 211 22
Section 212 22
Section 143(d) 20
Section 143(a) 20

PAGE

Revenue Act of 1913 ..... 5, 12
Section B 11
Section D 11, 17

Revenue Act of 1916 ..... 5, 6
Section 8(e) 13

Revenue Act of 1928 ..... 6, 23
Supplement F 17, 18, 24
Section 22(b)(4) 19
Section 211 22
Section 212 22
Section 144(a) 20
Section 144(d) 20

Revenue Act of 1934
Section 113(a)(13) 24n, 28n
Section 117 48
Section 143(a) 21
Section 143(d) 21

Revenue Act of 1938 7

Revenue Act of 1936
Section 23(g) 35

Section 240(a) of the Judicial Code, as amended by Act of February 13, 1925 1
Senate Report 63rd Cong. 1st Sess., S. Rept. 80, 1939-1 C. B. (Part 2) 5 48
Sol. Op. 42, 3 C. B. 61, 62 (1920) 14n

T. B. R. 64, 1 C. B. 171, 173 (1919) 14n
T. D. 2337 (Vol. 18, Treas. Dec. Int. Rev. (1916) p. 79) 12, 13
T. D. 2858, 1 C. B. 166 (1919) 14

Supreme Court of the United States

HARRY H. NEUBERGER,

Petitioner,

—*vs.*—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR PETITIONER

Opinions Below.

The opinion of the Board of Tax Appeals (R. 20-23) is reported in 37 B. T. A. 223. The opinion of the Circuit Court of Appeals (R. 46-47) is reported in 104 F. (2d) 649.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on June 12, 1939 (R. 46). A petition for rehearing was denied on June 28, 1939 (R. 51). By order signed September 26, 1939, the time to file a petition for certiorari was extended sixty days (R. 54). The petition for certiorari was filed on November 21, 1939 and was granted on May 27, 1940, limited to the second and third questions presented (R. 55). Jurisdiction is conferred on this Court by Section 240(a) of the Judicial Code, as amended by the act of February 13, 1925.

Questions Presented.

(1) Whether Section 23(r) of the Revenue Act of 1932 precludes petitioner, engaged in the single business of trading in securities for his own account and for the account of himself and another as partners, from offsetting his individual non-capital* security losses against his pro rata share of the partnership's non-capital security gains.

(2) Whether Section 23(r) is constitutional if construed to deny such offset.

Statutes Involved.

These are set forth in the appendix, *infra*, pages 51-58.

Statement.

The facts were stipulated (R. 12-19). From them the Board of Tax Appeals found in substance as follows (R. 20-22):

Petitioner, an individual, resided in New York. He was a floor member of the New York Stock Exchange, engaged in the business of trading in securities. He executed orders for his own account, for the account of Hilson & Neuberger, a partnership of which he was a member, and for customers of his firm.**

---

* Defined by §101 of the 1932 Act to mean securities held less than two years.

** As appears from the stipulation of facts, petitioner's activities were part of a single business of security trading. Paragraph 7 of the stipulation reads in part (R. 14):

"During the year 1932 petitioner was a member of the New York Stock Exchange, and spent practically every working day

During 1932, the taxable year in question, petitioner sustained a net loss from his individual trading in stocks and bonds which were not capital assets (as defined in Section 101 of the Revenue Act of 1932) in the aggregate sum of $25,588.93. In the same year the firm derived a profit of $142,802.29 from the sale of stocks and bonds which were not capital assets as defined in the said Act. It had other income of $170,830.65 and deductions of $203,981.78, or a net income of $109,651.06[.16]. Petitioner's distributive share of said profits amounted to $36,000 of the first $94,000, and 45% of the remainder.

On his 1932 return, petitioner sought to offset his individual loss of $25,588.93* from trading in non-capital securities against his share of the partnership's non-capital security profits (R. 15, 19). The Commissioner determined a deficiency of $9,021.24 in petitioner's 1932 income tax, resulting mainly from the disallowance of said offset (R. 7-10).

Petitioner sought review by the Board of Tax Appeals urging that the offset was proper, and that Section 23(r) of the 1932 Act was unconstitutional if construed to deny the offset (R. 3-5). The Board upheld the Commissioner, following the decision of the Second Circuit in *Johnston* v. *Commissioner,* 86 F. (2d) 732 (R. 20-23); but since it found for the petitioner on other issues, and since the petitioner

---

of the year 1932 on the floor of the Exchange, trading for the account of his firm (Hilson & Neuberger), executing orders on behalf of customers of said firm, and trading for his individual account."

---

*This item is shown on the return as $27,096.88, but was adjusted by agreement of the parties to $25,588.93 (R. 12). In the event of a reversal, further adjustment will be necessary by reason of the Board's action in allowing stamp taxes and sales commissions as deductions.

had made part payments on account of the deficiency while the case was pending in the Board, the decision was that there was an overpayment of $824.10 in 1932 income tax (R. 24).

Cross-appeals followed to the Second Circuit Court of Appeals (R. 25-29, R. 34-39). That Court affirmed the Board with respect to the issues presented by petitioner's appeal in a *per curiam* opinion, citing its prior decisions in the *Johnston* case and in *Davis* v. *United States*, 87 F. (2d) 323 (R. 46-47). A petition for rehearing (R. 48-51) was denied without opinion. The questions involved in the Government's appeal to the court below are not before this Court.

Specification of Errors To Be Urged.

(1) The court below erred in holding that petitioner, who was in the business of trading in securities, could not offset losses from the sale of non-capital securities owned by him individually against profits from the sale of similar securities owned by him and another as partners.

(2) The court below erred in holding that Section 23(r) of the Revenue Act of 1932, construed to prevent such offset, was constitutional as applied to a case where the taxpayer's business activities in trading for his own account and for the account of the partnership against whose profits he seeks to offset his losses were interwoven into one continuous course of business. Construed as it was by the court below in this case, Section 23(r) is so unreasonable and arbitrary as to violate the due process clause of the Fifth Amendment.

SUMMARY OF ARGUMENT.

I.

Section 23(r) of the Revenue Act of 1932 permits losses on the sale of securities held less than two years (non-capital securities) to be deducted only from profits on the sale of similar securities. We contend that, under this Section, petitioner is entitled to offset his individual non-capital security losses against his share of his partnership's non-capital security profits, by reason of the general principle which pervades all the Revenue Acts from 1913 to 1932 that items of partnership income retain the same character on individual partners' returns as they had on the partnership return.

In the interpretation of the 1913 Act, the Treasury ruled that items of partnership income could not be traced to their source behind the partnership for the purpose of claiming credit for such items on individual partners' returns. Congress was not satisfied with this interpretation, and in the 1916 Act, specifically gave credit to partners for those partnership items which the Treasury had ruled did not retain their identity on partners' returns. As to other items, the Treasury first ruled that they did not retain their identity, arguing that *expressio unius est exclusio alterius.* But in 1919, the Sixth Circuit having held in *United States* v. *Coulby,* 258 Fed. 27, affirming 251 Fed. 982, that under the 1913 Act items of partnership income retained their identity on partners' returns despite the absence of any such provision in the statute, the Treasury published the District Court's opinion as a Treasury decision. It has since repeatedly followed the *Coulby* case under later Acts, thereby abandoning the *"expressio unius"* rule of construction as applied to items of partnership income not specified in the statute.

Beginning with the 1916 Act, Congress has from time to time provided that specific items of partnership income retain their identity on partners' returns. In three instances where the 1928 and 1932 Acts made no such specific provision, the Treasury, applying the rule of the *Coulby* case, ruled that partners could treat such items as having the same source as they did to the partnership. Such action can be explained only as a recognition of the existence of the underlying general principle for which we contend.

It follows that, in carrying over the partnership sections of the 1928 Act verbatim into the 1932 Act, Congress reenacted the general principle, and petitioner is entitled to the offset in question, unless Section 23(r) of the 1932 Act requires a contrary result. The legislative history of that Section shows that it was intended only to prevent the deduction of speculative security losses from salaries, dividends, rents and similar income. No intention appears to prevent a member of a partnership from offsetting his individual non-capital security losses against his share of partnership non-capital security gains. In view of the well settled general principle, a clear expression of intention was necessary to effect such result.

Petitioner's contention as to the meaning and effect of Section 23(r) is supported by subsequent enactments. In 1933, to remove what it then considered an evil, Congress amended the partnership sections to deny to partners deduction of their shares of partnership non-capital security losses. No change was made as to partnership non-capital security gains, and the clear inference from the legislative history is that Congress thought that under the 1932 law, both non-capital gains and non-capital losses of partnerships retained their character on partners' returns.

The Treasury and the court below in *Johnston* v. ~~United States~~ Commissioner, 86 F. (2d) 732, Swan, *J.* dissenting, in holding that under the 1932 Act, partnership non-capital security gains do not retain their identity on partners' returns, exhumed the rule of construction, abandoned in 1919, that the specific mention in the statute of certain partnership items which do retain identity on partners' returns, excludes all others. In the 1938 Act, the first general Revenue Act following this decision, Congress expressly provided that "short-term" (i.e., non-capital) security gains retain their identity on partners' returns, the provision being described as "a logical corollary of the principle that only the partners as individuals, not the partnership as an entity, are taxable persons." As the corollary was no more logical in 1938 than in 1932, it is clear that Congress had at all times intended that the general principle should apply to partnership non-capital security gains.

If there be any uncertainty as to the construction of the statute, it should be resolved in petitioner's favor since grave constitutional doubts result from a contrary construction.

II.

If Section 23(r) is construed to prevent the offset in question, it is unconstitutional because it discriminated against petitioner in two respects entirely unrelated to the purpose which Section 23(r) was intended to accomplish:

1. The offset was permissible against individual non-security gains, but not against a taxpayer's share of partnership security gains. The Committee reports disclose no intention to penalize members of partnerships, and had they done so, there would have been no justification for such discrimination.

2. Traders in all types of assets other than corporate securities were permitted to deduct from ordinary income their losses on such other assets held less than two years. Only traders in corporate securities were penalized by Section 23(r). Except perhaps in the case of Government bonds, the Committee Reports disclose no excuse for this discrimination and none exists.

Constitutional questions are questions of degree. It is most unfair to tax petitioner on the profits from a security trading business without allowing as a deduction therefrom losses on security transactions in the same business.

POINT I.

Under the Revenue Act of 1932, petitioner, engaged in the single business of trading in securities on his own account and as a member of a partnership, may offset his individual losses from the sale of non-capital securities against his share of partnership gains from the sale of non-capital securities.

In 1932, petitioner's individual trading in non-capital securities (securities held less than two years) on the floor of the Stock Exchange resulted in net losses. In the same year, his partnership's trading in similar securities resulted in profits, petitioner's distributive share of which exceeded his own losses.

The question is whether petitioner may offset the losses against the profits, as he could without doubt if the profits had been realized by him individually; or whether the fact that the profits were earned by his partnership

rather than by petitioner individually requires the imposition of an income tax on the full amount of the profits without regard to the losses.

Both Section 23(r) of the Revenue Act of 1932, providing that losses from sales of non-capital securities shall be allowed only to the extent of gains from sales of such securities, and Supplement F of the 1932 Act, providing for the treatment of partnership income, are silent as to whether partnership non-capital security gains retain their identity in partners' hands for the purpose of offset of partners' individual security losses.

We contend that, pervading all the Revenue Acts from 1913 to and including 1932, there is a broad general principle that items of partnership income retain their identity in partners' hands in the absence of specific statutory provision to that effect, and that, therefore, petitioner's individual non-capital security losses may be used to offset his share of partnership non-capital security gains. From 1919 on, this general principle was accepted and applied by the Treasury in its administrative interpretations, with only two recent exceptions which are discussed *infra* pp. 29-31, 35.

We contend further that the legislative history of Section 23(r), and subsequent Revenue Acts, demonstrate conclusively that Section 23(r) was not intended to create an exception to this principle. The purpose of Section 23(r) was merely to prevent the deduction of non-capital security losses from salaries, rents, dividends and other similar income; not to prevent the offset of such losses against a distributive share of partnership non-capital security gains (See *infra* pp. 24-27).

The Treasury and the court below maintain that the specific reference in Supplement F of the 1932 Act to par-

ticular types of income which do retain their identity in partners' hands requires the conclusion that other types of income, not therein mentioned, do not retain their identity; in other words, *expressio unius est exclusio alterius* (*infra*, pp. 29-31).

Thus the question may be restated as follows: Is this a case, like *Helvering* v. *Clifford*, 309 U. S. 331, and *Helvering* v. *Hallock*, 309 U. S. 106, covered by a broad general principle of the Revenue Act, specific applications of which by particular provisions of the tax law do not limit the general rule; or is this a case not covered by a general principle, so that if petitioner does not fall within the express narrow provisions, he must fail on the construction question?

In determining this question, it is not important that for limited purposes a partnership has been held to be an entity.* The question here is whether income received by the partnership, and required to be reported by the partner, remains the same type of income on the partner's return as it was on the partnership's. For this purpose neither Congress, nor a majority of the Federal Courts passing on the question, nor the Treasury (at least from 1919 to 1935) have treated the partnership as an entity.

---

* Cases cited by the Government on the point that the partnership is an entity are discussed in the footnote, *infra*, pp. 23-24.

For the reason stated in the body, this brief will not discuss every instance where a partnership has been held not to be an entity. One such striking instance is the Treasury's refusal to treat salaries paid to partners as being other than distributions of partnership profits, on the ground:

> "'A partner receiving a salary is merely transferring money from one to another of his own pockets.' (*Leo Schwartz* v. *Commissioner*, 7 B. T. A. 223.)" G.C.M. 13771, XIII-2 C.B. 229, 230 (1934); G.C.M. 21418, 1939-2 C.B. 249, 250 (1939).

The Origin of the Principle that Items of Partnership Income Retain on Partners' Returns the Same Character They Had on the Partnership Return.

The first income tax law contained the following provision (Section D of the 1913 Act):

> That any persons carrying on business in partnership shall be liable for income tax only in their individual capacity, and the share of the profits of a partnership to which any taxable partner would be entitled if the same were divided, whether divided or otherwise, shall be returned for taxation and the tax paid, under the provisions of this section, * * *.

Section B of the statute provided that Government bond interest received by individual taxpayers was exempt from tax, and that dividends received from taxable corporations were exempt from normal tax.

The statute was silent as to whether these benefits were obtainable by taxpayers who received such interest or dividends through the medium of a partnership.

Thus under the very first income tax act, the question was posed whether there is a broad general principle that items of partnership income retain their identity in partners' hands, or whether in the absence of specific provision to that effect such items lose the character they had on the partnership return.

The inferences drawn by the Treasury from the silence of the statute were conflicting.

In a letter dated April 22, 1915, the Treasury ruled, in response to an inquiry as to the deductibility by partnerships

from their gross income of the amount of exempt interest received by them, " * * * that partnerships are permitted, in a computation of their net incomes for the purpose of ascertaining the distributable interest of partnership members, to deduct [such] item * * *." A similar ruling was issued early in 1916.*

On June 1, 1916, these rulings were superseded by T.D. 2337 (Vol. 18, Treas. Dec. Int. Rev. (1916) p. 79), which stated:

> The provisions of the law relating to the exclusion of income derived from interest upon National and State obligations and to the exclusion, for the purposes of the normal tax, of income derived from dividends, are applicable to income accruing to individuals and not to income accruing to partnerships, as such.

After referring to the omission from the 1913 Act of provision for exclusions from partnership income, T.D. 2337 continued:

> "the share of the profits of a partnership to which any taxable partner would be entitled if the same were divided, whether divided or otherwise," is subject to tax in the character of income derived from the partnership as the source, whatever its character may have been when it accrued to the partnership itself, and * * * the net distributive interests on which the individual members are liable for tax should include their proportionate shares of the profits of the partnership derived from [Government bond interest and dividends] * * *.

---

*The texts of both rulings appear in Montgomery, Income Tax Procedure, 1917 Ed., p. 108.

> All rulings and decisions in conflict herewith are hereby superseded and overruled.

Congress was not satisfied with this interpretation. Section 8(e) of the 1916 Act gave partners credit against normal tax for their proportionate shares of dividends received by the partnership, and excluded from their gross incomes their proportionate shares of the firm's exempt income.

Thus T.D. 2337 was nullified as to the points which it expressly covered (dividends and exempt interest). But the Treasury preserved its reasoning as to items not specifically covered by the 1916 Act. In Article 30 (par. 213) of Regulations 33 (Rev. Ed. 1918), the Treasury provided that, except for dividends and exempt bond interest, partnership income "can not be traced to its source behind the partnership for the purpose of claiming individual exemption."

This formalistic application of the *expressio unius est exclusio alterius* maxim was abandoned by the Treasury a year later, after the decision of the Circuit Court of Appeals for the Sixth Circuit in *United States* v. *Coulby*, 258 Fed. 27, decided early in 1919. In that case, the court affirmed, *per curiam*, a decision of the District Court holding that under the 1913 Act a partner was entitled to deduct from his income for normal tax purposes, his share of corporate dividends received by his partnership, even though there was no express provision to that effect in the Act.

The lower court had said (251 Fed. 982):

> An examination of the entire Income Tax Law convinces me that plaintiff's [the Government's] contention is erroneous. * * *

This law, therefore, ignores for taxing purposes the existence of a partnership. The law is so framed as to deal with the gains and profits of a partnership as if they were the gains and profits of the individual partner. The paragraph above quoted so provides [Section D *supra,* p. 11]. The law looks through the fiction of a partnership and treats its profits and its earnings as those of the individual taxpayer. Unlike a corporation, a partnership has no legal existence aside from the members who compose it. The Congress, consequently, it would seem, ignored, for taxing purposes, a partnership's existence, and placed the individual partner's share in its gains and profits on the same footing as if his income had been received directly by him without the intervention of a partnership name.

It follows, from these considerations, that legally the defendant's share of the gains and profits of Pickands, Mather & Co., derived from corporations taxable on their net incomes, is to be treated as if the same had been received by him directly from the taxpaying corporations (pp. 983-984).

The Treasury acquiesced in this decision and promulgated the District Court's opinion as T.D. 2858, 1 C.B. 166 (1919). The *Coulby* case has since been repeatedly followed by the Treasury.*

The Government has conceded that, since T.D. 2858, it has in most instances accepted the principle expressed therein as the law, even under subsequent Revenue Acts.

---

* T.B.R. 64, 1 C.B. 171, 173 (1919); O. 972, 2 C.B. 163, 165 (1920); A.R.M. 13, 2 C.B. 168 (1920); Sol. Op. 42, 3 C.B. 61, 62 (1920); I.T. 1576, II-1 C.B. 144 (1923); A.R.R. 2859, II-2 C.B. 159, 162 (1923); G.C.M. 2467, VII-2 C.B. 188, 192 (1928); G.C.M. 13771, XIII-2 C.B. 229, 230 (1934).

In its brief dated November 1939, in *Craik* v. *United States,* decided by the Court of Claims on February 5, 1940, 31 F. Supp. 132, the Government said (p. 78):

> In its consideration of the problem presented in this case the Court should be apprised of the fact that since the adoption of the decision of the District Court in the *Coulby* case as T.D. 2858; C.B. I, p. 166, the Commissioner of Internal Revenue, although he has never formally ruled on the subject, has in most instances accepted the principle expressed therein as the law even under subsequent revenue acts. See, however, G.C.M. 21478 reported in 1939 CCH, par. 6455.*

In the same brief the Government said of the *Coulby* case (pp. 70, 71):

> No appeal was taken from the decision of the Circuit Court of Appeals and although Article 30 of Regulations 33 was never formally withdrawn, no comparable provision appeared in regulations interpreting subsequent revenue acts. It should be noted that the *Coulby* case related to the Revenue Act of 1913 and Article 30 of Regulations 33 dealt with the Revenue Act of 1917. The trend of authorities from 1917 to 1928 was unquestionably contrary to the context of Article 30 of Regulations 33. Cf. *App. of Schwartz,* 7 B. T. A. 233; S.O. 42, 3 C.B. p. 61. The common-law rule that all partnership property belonged individually to the partners, and income when received automatically and instantaneously

---

*G. C. M. 21478 held that individual gambling losses may not offset a distributive share of partnership gambling gains under the 1936 Act. The Fifth Circuit has rejected this ruling. *Jennings* v. *Commissioner,* 110 F. (2d) 945, *infra* pp. 35-36.

> became individual property of the partners, was obviously the premise upon which the Board of Tax Appeals and the Courts determined the tax matters of individual partners as late as 1928. Cf. *App. of Lloyd*, 15 B. T. A. 82.

We shall deal later (p. 23) with the question whether there was any change after 1928, the year referred to in the above quotation.

In its opinion in the *Craik* case, the Court of Claims referred to the rule that partnership income retains its identity in the partners' hands, and said (31 F. Supp. at 135):

> The Bureau of Internal Revenue has so treated partnership income for twenty years. * * *
>
> It is admitted that since this time [the decision in the *Coulby* case] partnership income has been so treated by the Bureau.*

Thus, since 1919, the Treasury has accepted the general principle that items of partnership income retain their identity in the individual partner's hands in the absence of any express provision to that effect in the statute. We contend that this principle was still in force in 1932, and was not affected by the adoption of Section 23(r) of the 1932 Act.

The Government's concession in its *Craik* brief is borne out by the income tax statutes, administrative practice, and judicial decisions, to which we now turn.

---

* Sixteen years probably would be more accurate than twenty, since the first contrary ruling of the Treasury was made in 1935 (*infra*, p. 29).

Statutory and Administrative Applications of the General Rule that Items of Partnership Income Retain the Same Character on Partners' Returns as They Had on the Partnership Return.

Each of the Revenue Acts has contained a provision substantially identical to Section D of the 1913 Act (*supra*, p. 11) to the effect that partners are liable for income tax only in their individual capacity and are taxable on their distributive share of partnership profits, whether distributed or not. In addition, beginning with the 1916 Act, provisions were included from time to time affecting the treatment on partners' returns of specific types of partnership income.

These specific provisions are applications of the general rule that partnership income retains its identity on the partners' returns.

There has never been a provision in any income tax law denying to a partner the right to treat an item of partnership income as retaining the identity it had on the partnership return.

The various sections dealing with the treatment of partnership income and deductions were collected in one place for the first time in the Revenue Act of 1928, Supplement F, printed in the appendix, pages 55-57, and were repeated verbatim in the 1932 Act.

Sections 181, 182, 183 and 189 of Supplement F set forth the general rules that

(1) partnerships are not taxable, partners being liable for income tax only in their individual capacity;

(2) partners are liable for income tax on their distributive share of partnership net income, whether distributed or not;

(3) partnership net income shall be computed in the same way as that of an individual except that the charitable contribution deduction* shall not be allowed; and

(4) the partnership shall make a return stating specifically the items of its income and deductions and the amount of each partner's distributive share.

Sections 184, 185 and 186 provide that four types of partnership income retain their character on partners' returns. These are dividend income, Government bond interest, earned income, and capital gains. Sections 186 and 187 deal with the treatment on partners' returns of partnership capital losses and net losses carried over from preceding years. Section 188 gives to partners credit against their taxes for their proportionate shares of taxes paid by the partnership to foreign countries and possessions of the United States.

All these Sections are specific applications of the general principle that partnership income retains its character in partners' hands.

There are three other types of income, treatment of which on returns of individual partners is not covered by Supplement F of the 1928 and 1932 Acts.

---

* Despite this provision, the Treasury ruled that each partner could deduct on his own return his proportionate share of the partnership contributions disallowed to the partnership by the statute (Art. 261(e), Regs. 74, 1928 Act, and Regs. 77, 1932 Act). This Regulation can be justified only as an application to deductions of a basic principle similar to that which we contend applies to the partnership income.

In each case, the Treasury filled the gap by applying the general rule that partnership income retains its identity in the partners' hands:

1. Section 22(b)(4) of the 1928 and 1932 Acts, read together with the Acts authorizing the issuance of certain United States obligations, provides that interest on Government bonds of a principal amount in excess of $5,000 shall be included in gross income.

The taxability of interest on partnership owned Government bonds in a principal amount exceeding $5,000 raises this question:

Suppose a partnership with two equal members owns $10,000 principal amount of Government bonds. Is each partner exempt from surtax on the interest on $5,000 principal amount of bonds, or is his exemption limited to the interest on $2,500 principal amount, his one-half of the $5,000 principal amount interest on which is exempted under Section 22(b)(4)?

A literal reading of the statute would seem to require the latter conclusion, since Supplement F contains no provision exempting partners from surtax on partnership Government bond interest income. However, the Treasury has at all times applied to this situation the general principle for which petitioner contends.

Articles 89(b) (Regs. 74, 1928 Act) and 88(b) (Regs. 77, 1932 Act) provide:

> As the income of a partnership is taxable to the individual partners, each partner is entitled to exemption as if he owned directly a proportionate part of the bonds held by the partnership.

Hence in the example given above, each partner is exempt from surtax on the interest on $5,000 principal amount, not merely on $2,500.

In this instance the Treasury has not reasoned that *expressio unius est exclusio alterius,* although Section 184, which gives credit for normal tax, indicates that Congress was thinking of the question of taxability of Government bond interest in partners' hands.

This interpretation has been continued in the 1940 edition of the Regulations. Regs. 103, Sec. 19.22(b)(4)-5(b).

2. Sections 144(a) (1928 Act) and 143(a) (1932 Act) provide for withholding at source of a tax of 2% on bond interest paid to individuals and partnerships.

Sections 144(d) (1928 Act) and 143(d) (1932 Act) provide that income upon which tax is withheld shall be included in the return of the recipient of the income, but the amount of tax so withheld shall be credited against the recipient's income tax.

If *expressio unius est exclusio alterius,* individual partners should receive no credit for taxes withheld at source from the partnership, there being no provision in Supplement F authorizing partners to take such credit, whereas Supplement F does allow credit to partners for taxes paid by the partnership to foreign countries and to possessions of the United States.

However, the Treasury rules that partners are entitled to their proportionate shares of taxes withheld at source on income paid to the partnership.

The partnership income tax forms for 1928 and 1932 contained space for the separate listing of each partner's share of the 2% tax withheld from the partnership, and the instructions on individual income tax blanks permitted partners to take credit for their shares of withheld taxes. (Forms 1040 and 1065.)

In G. C. M. 18120, 1937-1 C. B. 151 (1937), the Treasury ruled that under the 1934 Act (Sections 143(a) and (d) of which are substantially similar to those Sections in the 1932 Act), a partner was entitled to a proportionate share of taxes withheld at source from the partnership, even though the partnership had no net income. No mention is made of the argument that, since an express reference was made to credit for taxes paid by partnerships to foreign countries and United States possessions, the omission of a reference to taxes withheld at source was deliberate. On the contrary, the ruling assumes without question that a partner is entitled to treat income received by the partnership as retaining its identity on his return.

Even though interest was merged on the partnership return with other ordinary income, and even though the partnership in question had no net income, the Treasury held that the interest retained its identity on the partner's return, saying (1937-1 C. B. at 152):

> Nevertheless, if the interest is reflected in the taxpayer's return, it is "included" therein and therefore meets the requirement of Section 143(d) [providing that the tax withheld may be credited on the return of the recipient of the interest].

This ruling has not been revoked, and represents the continuing acceptance by the Treasury of the principle that part-

nership income retains its identity in partners' hands. The 1939 individual and partnership income tax returns (Forms 1040 and 1065), and instructions attached thereto, give to partners their shares of the credit for taxes withheld from the partnership.

3. Under Sections 211 and 212 of the 1928 and 1932 Acts a non-resident alien individual is taxable only on his income from sources within the United States.

The statute is silent as to whether a non-resident alien member of a domestic partnership which has income from sources without the United States, is taxable on his share of such income, or whether he is entitled to treat his share of partnership income from foreign sources as retaining its identity, with resultant elimination of tax thereon.

In G. C. M. 13771, XIII-2 C. B. 229 (1934), the Treasury applied the rule of the *Coulby* case to this situation and held that under the 1928 Act a non-resident alien member of a domestic partnership is exempt from tax on his share of partnership income from foreign sources, despite the absence of any statutory provision to that effect.*

Here again the Treasury made no argument based upon Congress' failure to include this type of income with the others which Supplement F specifically provides should retain their identity in the hands of partners.

G. C. M. 13771 remains in force, and its continued acceptance by the Treasury is shown by the failure to seek

---

* In 1936 this ruling was modified by G. C. M. 17255, XV-2 C. B. 243, in a particular not material here. The ruling re-stated the general principle that the foreign income of the partnership remained foreign in the hands of the individual partner.

certiorari in *Craik* v. *United States*, 31 F. Supp. 132 (1940), *infra* pp. 36-40, which reached the same result.

The General Rule that Items of Partnership Income Retain the Same Character on Partners' Returns as They Had on the Partnership Return Was Carried Over Into the 1932 Act.

Thus with respect to three separate items of partnership income, the Treasury interpreted the 1928 Act in the light of the general principle for which petitioner here contends.

We know of no instance during the period from 1928 to 1932 in which the Treasury took a different view.* On the contrary, in the three instances in which the 1928 and 1932 Acts made no provision for the treatment of partnership income on partners' returns, the practices adopted under the 1928 Act were continued under the 1932 and later Acts and rulings, as has just been shown.

---

* In its brief in the *Craik* case, the Government cites four cases to establish that since 1928 the Board and courts have treated partnerships as entities: *Edward B. Archbald*, 27 B. T. A. 837 (1933), affd. 70 F. (2d) 720, cert. den. 293 U. S. 594; *Percy H. Johnston*, 34 B. T. A. 276 (1936), affd. 86 F. (2d) 732, cert. den. 301 U. S. 683; *W. J. Burns*, 12 B. T. A. 1209 (1928); *Lord Forres*, 25 B. T. A. 154 (1932). The *Johnston* case is discussed *infra* pp. 28-31. The *Lord Forres* case merely follows the *Burns* case.

It is immaterial in this case that for certain limited purposes partnerships are treated as entities. For the purpose of determining whether partnership income retains its character on partners' returns, neither Congress nor a majority of the Federal Courts passing on the question, nor the Treasury (at least from 1919 to 1935) have treated partnerships as entities. The cases cited do not establish that any change took place in this respect between 1928 and 1932.

Of these, only the *Burns* case was decided in 1928. There the Board held that a partner reporting on the cash basis was entitled to deduct his *pro rata* share of accrued foreign taxes of his partnership, which reported on the accrual basis. The Board pointed out that a partnership was treated as an entity for the purpose of *computation*

It follows that, in carrying over Supplement F verbatim into the 1932 Act, Congress must be deemed to have reenacted the general principle that partnership income retains its identity in partners' hands where no specific provision is made in the statute; accordingly the offset here in question was proper unless Section 23(r) of the 1932 Act was intended by Congress to accomplish a different result. Section 23(r) provides**:

> Losses from sales or exchanges of stocks and bonds (as defined in subsection (t) of this section) which are not capital assets (as defined in section 101) shall be allowed only to the extent of the gains from such sales or exchanges * * *.

---

of income since to disregard such entity would result in the distortion of partnership income (12 B. T. A. at 1224). But the Board did not state and it does not follow from its holding that partnerships are entities for the purpose of changing the nature of partnership income in partners' hands. This is borne out by the *Archbald* case, *supra*. There the question was the amount of gain taxable to a partner on securities contributed by him to a partnership and sold by it at a profit. The Commissioner contended that because partnerships were not taxable, their existence must be ignored in determining the chain of ownership and that the partner's cost was therefore the basis to the partnership. The Board held otherwise on the ground that partnerships were regarded as entities for the purpose of *computing* partnership gain. In citing the *Coulby* case as a consistent holding, the Board said: "Since, then, a partnership is treated sometimes as an entity and sometimes not, its nontaxation carries no implication of the measure of its income or that of the individual partners" (27 B. T. A. at 841). The principle preserving the identity of partnership income in partners' hands was not questioned. The result urged by the Government in the *Archbald* case was brought into the statute by the Revenue Act of 1934, Sec. 113 (a) (13).

** Section 23(r)(2) of the 1932 Act provided that losses disallowed by Section 23(r) could be carried forward to the succeeding year with limitations. The carry-over was repealed by Section 218(b) of the National Industrial Recovery Act.

We challenge the Government to point to anything in this Section, or in the 1932 Act, or in the Committee Reports, that indicates Congress intended to prevent the offset of individual non-capital security losses against a partner's share of partnership non-capital security gains.

The purpose of Section 23(r) was only to prevent the deduction of speculative security losses from salaries, dividends, rents and similar income. As the Ways and Means Committee said (72nd Cong., 1st Sess., H. Rept. 708, p. 12):

> There are no provisions in existing law corresponding to section 23(r), (s), (t), (u), and (v). Many taxpayers have been completely or partially eliminating from tax their income from salaries, dividends, rents, etc., by deducting therefrom losses sustained in the stock and bond markets, with serious effect upon the revenue. Your committee is of the opinion that some limitation ought to be placed on the allowance of such losses.

The House bill forbade the deduction of any security losses (whether the security was held more or less than two years), except to the extent of security profits. The Senate Finance Committee, which limited the new provision to securities held less than two years, explained the purpose of Section 23(r) as follows (72nd Cong., 1st Sess., S. Rept. 665, p. 10):

> The House bill adopted very severe limitations upon the allowance of losses from the sale of securities, as a deductio. in computing net income. The provision was based upon a twofold policy: (1) Protecting the revenues from the growing practice of reducing tax liabilities by the sale of securities on which losses had accrued, and (2) preventing speculative losses from wip-

ing out ordinary income, which represents real tax-paying ability.

Your committee is of the opinion, however, the House bill went much further than the situation necessitated. Securities held for more than two years have been in the hands of investors. The losses they have suffered are decidedly real losses. * * * The existing limitation, that capital losses can not reduce the tax by more than 12½ per cent, is adequate protection against excessive deductions. Accordingly, your committee is of the opinion that no change in this respect should be made in the existing law.

A somewhat different situation exists with respect to losses realized from the sale of securities held by the taxpayer for less than two years. These losses should properly be permitted only as an offset against gains from securities held for less than two years. But undue hardship under existing conditions should be avoided. Your committee believes that security gains and losses should be segregated, that security losses should be deducted solely from security gains; but that security gains should not be taxed until they actually exceed security losses.

The House accepted the Senate's version. Thus the intention of Congress was only to limit the deduction of non-capital security losses to the amount of non-capital security gains, and to prevent their deduction from salaries, rents, dividends, interest and similar income. No intention appears to tax partners on their distributive shares of partnership non-capital security gains if such partners had individual non-capital security losses. In view of the well settled principle of treating partnership income as retaining its identity on the partners' returns, a clear expression of intention was necessary to deprive partners of such set-off.

It is inconceivable that Congress would change the general rule applicable to partnership income in a fashion as indirect as adopting Section 23(r) without mentioning partnerships in the Committee Reports and without amending Supplement F, containing the partnership sections.

Petitioner's Interpretation of the 1932 Act Is Confirmed by Section 218(d) of the National Industrial Recovery Act.

When in 1933 Congress sought to change the treatment of partnership security transactions, it did so by direct amendment to Supplement F. The Senate Finance Committee investigations of Stock Exchange practices having disclosed that, during the depression years, partners of private banking houses had eliminated their personal income taxes by the application of partnership security losses against their individual incomes, Congress enacted Section 218(d) of the National Industrial Recovery Act as follows:

> Effective as of January 1, 1933, section 182(a) of the Revenue Act of 1932 is amended by inserting at the end thereof a new sentence as follows: "No part of any loss disallowed to a partnership as a deduction by section 23(r) shall be allowed as a deduction to a member of such partnership in computing net income."

In explaining the amendment, the Senate Finance Committee said (73rd Cong., 1st Sess., S. Rept. 114, p. 7):

> Subsection (d) *amends* the partnership provisions of existing law. Under *existing* law the individual members of a partnership are entitled to reduce their individual net incomes by their distributive shares of a net loss incurred by the partnership. *Your committee amendment denies nis deduction* to the extent that the net

> loss is attributable to a loss from the sale or other disposition of stocks and bonds. (Italics supplied.)

It would be difficult to phrase more clearly an intention to change the law. Yet the majority of the court below in *Johnston* v. *Commissioner,* 86 F. (2d) 732, cert. den. 301 U. S. 683, on the authority of which this case was decided, said that Section 218(d) did not change the law, but was "inserted out of abundant caution * * * and as but a clarification of existing law" (86 F. (2d) at 734).

In so holding, the court disregarded

(1) the limitation of the amendment to January 1, 1933. Presumably Congress thought the law of 1932 was to the contrary.

(2) the express statement by the Senate Finance Committee that it was making a change.*

(3) the emergency character of the National Industrial Recovery Act. This was hardly the occasion for a restatement of a minor portion of existing law as to partnership income.

(4) the purpose of the particular section to remove a newly discovered evil, as disclosed in the Senate Finance Committee Report.**

---

* Where a mere restatement of prior law is intended, Congress frequently indicates that such is its intention. In the Report of the House Ways & Means Committee on the 1934 Revenue Act, for example, it is stated with respect to a proposed change in the language of §113(a)(13) (73rd Cong., 2d Sess., H. Rept. 704, p. 18):

> The committee believes that this provision embodies merely the correct interpretation of the present law, but it appears desirable to have an express statement of the rule in the statute.

** 73rd Cong., 1st Sess., S. Rept. 114, p. 5.

(5) the limited scope of the language. Section 218(d) refers only to partnership losses, not to partnership gains. This is logical, since the statute was passed to remove a particular evil, believed to exist despite Section 23(r). If the statute had been intended to restate existing law, a more comprehensive provision covering profits as well as losses would have been enacted.

In effect the majority in the *Johnston* case say that Section 218(d) was unnecessary. In view of the foregoing, this conclusion is clearly unsound.

Congress Has Indicated Its Disapproval of the Failure of the Treasury and the Court Below to Apply to Security Profits the General Rule that Items of Partnership Income Retain the Same Character on Partners' Returns as They Had on the Partnership Return.

Between the enactment of Section 218(d) in 1933 and the decision in the *Johnston* case in 1936 the Treasury ruled on the question here presented. In G. C. M. 14012, XIV-1 C. B. 145 (1935), the Treasury held that individual non-capital security losses may not be offset against partners' shares of partnership non-capital security gains. The basis of the ruling follows:

> Section 181 of the Revenue Act of 1932 provides that individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. Under the "general rule" of section 182, however, the "tax of partners" is arrived at by including in the individual partners' returns their distributive shares of the partnership net income, which (under section 183) is "computed in the same manner and on the same basis as in the case of an individual, except that the so-called

'charitable contribution' deduction provided in section 23(n) shall not be allowed." In general, therefore, the items of partnership gross income and deductions do not affect a partner's income immediately as in the case of his non-partnership income, but only through the medium of the partnership return (section 189) showing his distributive share of the partnership net income or net loss (article 902, Regulations 77).

The express mention of section 184 "credits against net income," section 185 "earned income," section 186 "capital net gains and losses," and section 188 "taxes of foreign countries and possessions of the United States" as items which may directly affect the partners' net income without intervention of the partnership return emphasizes the implication that Congress intended the "general rule" of Section 182 and 183 to be otherwise an exclusive method of computing partnership income, thus limiting the exceptions to those specified (pp. 146, 147).

No reason is given for the sudden resurrection, after sixteen years, of the abandoned principle that the specification in the statute of instances in which particular types of partnership income retain identity in partners' hands precludes other types of partnership income from retaining their identity.* No reference is made to the *Coulby* case; or to G. C. M. 13771, *supra*, page 22, adopted in 1934 and applying the *Coulby* case to income from foreign sources; or to the prior consistent legislative and administrative principle of treating partnership income as retaining its identity on the partners' returns.

---

*The ruling also cites cases apparently in an effort to show that for some purposes a partnership is an entity. We have already disposed of this contention (*supra*, p. 10, footnote, p. 23).

The reasoning of G. C. M. 14012 was accepted by a majority of the court below, Swan, *J.* dissenting, in the *Johnston* case. The argument thus accepted was completely demolished by Judge Swan in his dissenting opinion as follows (86 F. (2d) at 735):

> In determining taxable gains on noncapital assets, a taxpayer is allowed to offset losses on the sale or exchange of similar assets. I cannot imagine any reason why the Congress should wish to tax a man more if he made his gains in conjunction with a partner than if both gains and losses were wholly individual. Prior to the enactment of section 23(r), there was admittedly no such purpose, and a loss sustained on assets held individually could be offset against gains on assets owned in partnership. That section itself does not express an intention now to forbid it, but my brothers find such an intention in a negative implication from other sections which relate to credits against net income. To my mind those sections carry no implication against a deduction from gross income—the issue before us. They were taken over from earlier acts under which they carried no implication that a deduction of the sort now demanded was not permissible. I think it is still permissible, since the language of the new provision, section 23(r), does not forbid it. In my opinion, the order should be reversed.

Judge Swan's criticism has even more force today than in 1936 since, before the court below decided this case, Congress had already expressed its understanding of the law as petitioner urges it here. In the 1938 Act, the first general Revenue Act following the decision in the *Johnston* case, Congress provided:

Sec. 182. Tax of partners.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

(a) As a part of his short-term capital gains* or losses, his distributive share of the net short-term capital gain or loss of the partnership.

(b) As a part of his long-term capital gains or losses, his distributive share of the net long-term capital gain or loss of the partnership.

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183(b).

The House Ways and Means Committee explained the changes in the partnership sections as follows (75th Cong., 3rd Sess., H. Rept., 1860, pp. 42-43):

> *The method of treatment provided in these sections of the bill is a logical corollary of the principle that only the partners as individuals, not the partnership as an entity, are taxable persons* and is necessary to give the partners as individuals the benefit of the alternative tax in the case of net long-term capital gains, provided in section 117 (c), with respect to such gains realized upon the sale or exchange of partnership capital assets. It should be noted that *this method involves a departure*

---

* In distinguishing between short-term and long-term capital gains and losses, the 1938 Act in effect restored the law as it stood in 1932. As applied to securities, the term "short-term capital gains" is roughly equivalent to the term "non-capital security gains" under the 1932 Act, and the term "long-term capital gains" under Section 182(b) of the 1938 Act is roughly equivalent to the term "capital gains" as used in Section 101 of the 1932 Act. Between 1934 and 1938, all assets were treated as capital assets regardless of the time held, with a sliding scale of percentages based upon the length of the holding period.

> *from the principle adopted in the Revenue Acts of 1934 and 1936* to the extent that it enables capital *net losses* of the partnership in the respective categories to be applied, on the basis of the partners' allocable shares thereof to offset their individual capital net gains in the same categories. (Italics supplied.)

As the corollary was no more logical in 1938 than in 1932, it is clear that Congress believed that the Revenue Act at all times permitted partnership short-term security gains* to retain their identity on partners' returns. This conclusion is supported by the reference in the above quotation to the Revenue Acts of 1934 and 1936. Those Acts had continued the policy first adopted in Section 218(d) of the National Industrial Recovery Act of disallowing to partners the deduction of partnership security losses. The 1938 Act restored to partners the privilege of deducting partnership security losses. The Committee Report carefully notes the change thus made in the law. Obviously, the Committee believed it was making no change by expressly applying to partnership "short-term" (i.e., non-capital) security gains the general principle that partnership income retains its character on partners' returns.

The bearing of the 1938 Act on the present controversy is identical with that of the 1916 Act on the question in the *Coulby* case. There the issue was whether, under the 1913 Act, partners were allowed a credit against normal tax for dividends received by the partnership in the absence of specific statutory provision. The 1916 Act expressly allowed such credit. The Government argued that the later statute showed that Congress believed that the law under the earlier Act was different. The District Court rejected the argument, saying:

---

* See preceding footnote.

> I do not agree with this contention. In my opinion, this provision was inserted in the 1916 Act to put at rest the present controversy, rather than to change the law, and is to be regarded only as a legislative recognition of the scope and intent of the prior law. [Citing cases, 251 Fed. at 985.]

This Court has reached a similar conclusion in dealing with the effect of other later enactments upon the interpretation of earlier Revenue Acts. *Helvering* v. *New York Trust Co.*, 292 U. S. 455; *Jordan* v. *Roche*, 228 U. S. 436.

A Majority of the Federal Courts Passing on the Question Have Held that Items of Partnership Income Retain on Partners' Returns the Same Character They Had on the Partnership Return.

Two Circuit Courts of Appeals and the Court of Claims have held squarely that partnership income retains its identity in partners' hands in the absence of specific statutory provision to that effect. *United States* v. *Coulby*, 258 Fed. 27 (C. C. A. 6); *Jennings* v. *Commissioner*, 110 F. (2d) 945 (C. C. A. 5) (pending on petition for certiorari); and *Craik* v. *United States*, 31 F. Supp. 132 (Court of Claims). Only the court below, Swan, *J.*, dissenting, in the *Johnston* case,* *supra*, pp. 28-31, and the Court of Claims, in a case which followed the *Johnston* case and which was decided before the *Craik* case, have accepted the reasoning of G. C. M. 14012, *Klingenstein* v. *United States*, 18 F. Supp. 1015.**

---

* The Second Circuit followed the *Johnston* case in *Winmill* v. *Commissioner*, 93 F. (2d) 494, reversed on another point, 305 U. S. 79, and in several *per curiam* decisions.

** The Court of Claims followed the *Johnston* and *Klingenstein* cases in *Mosbacher* v. *United States*, 30 F. Supp. 703, pending on petition for certiorari, which was decided before the *Craik* case, *supra*.

The *Coulby* case has been fully discussed, *supra,* pp. 13-16. Its importance cannot be too greatly stressed, in view of its unquestioned acceptance by the Treasury in a series of rulings promulgated over a span of sixteen years (*supra,* p. 14).

In the *Jennings* case, *supra,* the taxpayer sought to offset individual gambling losses against her share of partnership gambling gains. Section 23(g) of the 1936 Revenue Act provided that losses from wagering transactions are allowable only to the extent of gains from such transactions, just as Section 23(r) of the 1932 Act provided that non-capital security losses are allowable only to the extent of non-capital security gains. There was no provision in the 1936 Act that partnership wagering gains retain their identity in partners' hands, just as there was none in Supplement F of the 1932 Act regarding partnership non-capital security gains. The Treasury and the Board of Tax Appeals held against the taxpayer, following the *Johnston* case. G. C. M. 21478, 1939-2 C. B. 159; B. T. A. Memo., Docket No. 94529, July 25, 1939. The Fifth Circuit reversed by a divided court, Judge Sibley saying:

> A partnership is recognized as an entity separate from the partners in bankruptcy proceedings, but not in income taxation. *United States* v. *Coulby,* 6 Cir., 258 F. 27. For many years the Revenue Acts have provided that "individuals carrying on business in partnership shall be liable for income tax only in their individual capacity." Revenue Act of 1918, §218(a), 40 Stat. 1057, 1070, Revenue Act of 1936, §181, 49 Stats. 1648, 1709, 26 U. S. C. A. Int. Rev. Code, §181. Thereunder a tax on income earned in partnership was held not a claim against the partnership in bankruptcy, and it went unpaid for lack of individual assets. *United States*

> v. *Kaufman,* 267 U. S. 408, 45 S. Ct. 322, 69 L. Ed. 685. The partnership return is for information, and to secure uniformity and save repetition in the individual returns. It ascertains each partner's gain and apportions it to him to be taxed, whether distributed or not. It does not transform his share in the gain. If "individuals carrying on business in partnership," to use the phrase of the statute, make gains in wagering transactions, the share of each is a wagering gain; and when it is entered on his individual return to be taxed, a deduction of his losses in other wagering transactions is allowed by the statute, but only to the extent of such gains.

Referring to the *Johnston* case, Judge Sibley continued:

> We are impressed that the dissenting judge was probably right, but that case dealt with a different statutory provision, and it had been amended by Congress, the purpose of the amendment being one of the disputed points (110 F. (2) at 946).

The amendment to which the Fifth Circuit refers is Section 218(d) of the National Industrial Recovery Act, discussed *supra,* pp. 27-29. That amendment did not apply to 1932, the year in question here, and it dealt with the converse of the question in this case, i. e., whether partnership security losses may be offset against individual security profits. We have demonstrated (*supra,* pp. 27-29) that Section 218(d) supports our view that under the 1932 Act partnership security gains retain their identity on partners' returns.

In *Craik* v. *United States,* 31 F. Supp. 132, the Court of Claims held that a non-resident alien member of a domestic partnership was not taxable on his distributive share of in-

come derived by the partnership from sources without the United States, although the applicable Acts were silent as to the right of a non-resident alien partner to such exclusion. Whitaker, *J.* wrote:

> An examination of the various income tax Acts, beginning with the first one of 1913, shows that Congress in the enactment of each of them intended to treat partnership income as though the distributive share of each partner therein had been received directly by the partner (p. 133). * * *
>
> The treatment of partnership income on the same basis as though it had been received by the partner directly is consistent with the common-law idea of a partnership (p. 134). * * * The income earned by the partnership was regarded as having been earned by each of the individual partners, either by himself individually or through his agents, the other partners.
>
> The Bureau of Internal Revenue has so treated partnership income for twenty years. Originally it promulgated a regulation providing that partnership income could not be traced to its source behind the partnership for the purpose of claiming individual exemption. This ruling, however, was questioned and presented to the District Court for the Northern District of Ohio. On June 26, 1918, the court rendered an opinion holding that the Revenue Acts treat a partnership's "* * * profits and its earnings as those of the individual taxpayer. * * * The Congress, consequently, it would seem ignored, for taxing purposes, a partnership's existence, and placed the individual partner's share in its gains and profits on the same footing as if his income had been received directly by him without the intervention of a partnership name." *United States* v. *Coulby,* D. C.,

> 251 F. 982, 984. This case was affirmed on appeal. *United States* v. *Coulby,* 6 Cir., 258 F. 27.
>
> It is admitted that since this time partnership income has been so treated by the Bureau. In the light of this administrative practice Congress has continued to enact substantially the same provisions for the treatment of partnership income (pp. 134, 135).

In the *Craik* case, the Court of Claims attempted to distinguish the *Johnston* decision. The attempt is hollow. Read as a whole, the opinion in the *Craik* case cannot be squared with the *Johnston* decision. The Court of Claims said (31 F. Supp. at 135):

> The Court (in the *Johnston* case) thought that Congress by providing for certain specific credits against a partner's income on account of his share of partnership profits, thereby impliedly prohibited any other credit. The Court called attention to the fact that the Act expressly provided for taxing the partners on their distributive share of capital net gains as if it had been received by them individually, and thought that its failure to mention noncapital gains and losses indicated that it did not intend that they should be treated similarly. This case was followed by this court in *Klingenstein* v. *United States,* 85 C. Cls., 164; 18 F. Supp. 1015.
>
> Congress' attention having been given to gains and losses, and having provided for the treatment of capital gains and losses as if they were the gains and losses of the individual partners, and not having made such provision for noncapital gains and losses, there was room for the conclusion reached in the *Johnston* case, *supra.*

Having said so much, the Court proceeded to demolish its support of the *Johnston* case as follows (31 F. Supp. at 135-6):

But we do not think that by the specification of certain items for which the partner might take credit Congress intended to exclude all others, if the exclusion of them would result in the treatment of partnership income in a way different from what it would have been treated had it been received by the partners individually.

It is, of course, within the power of Congress to limit deductions from gross income to any extent it pleases, but our study of the pertinent sections of the 1916 and 1918 Acts and of related sections of other acts persuades us that Congress intended that an individual should have every deduction from partnership income which he might take from his individual income, unless the contrary clearly appears.

However, we are dealing here not with what credits or deductions a partner is entitled to, but what he shall include in his gross income. We are convinced that Congress intended that partnership income should be treated as though it had been received by the partners individually. If we are correct in this, then this plaintiff's proportionate share of the partnership income received from sources without the United States should be treated as though he himself had received this income directly, and not through the conduit of the partnership. If so, in computing his income, his proportionate share of the income from sources without the United States should be excluded.

The defendant further takes the position in its brief that the plaintiff received his income from the partnership, and since the partnership was a "domestic partnership" his income was from sources within the United States, from whatever source the income might have been derived by the partnership. This cannot be true unless the partnership is regarded as a separate entity,

and this the Revenue Act does not do. (*Cf. Dorothy S. Bence* v. *United States,* 84 C. Cls., 605; 18 F. Supp. 848.)

If the *Johnston* case correctly held that a partner should not be given credit for his share of specific items of partnership income except where the Revenue Act expressly so provides, the Court of Claims could not have held for the plaintiff in the *Craik* case, since there was no specific provision in the Acts before that Court giving a non-resident alien partner credit for his share of the partnership's foreign income, while there were specific provisions in those Acts giving a partner credit for his share of other kinds of partnership income (dividends and Government bond interest). Apparently the Court of Claims was embarrassed by its earlier decision in the *Klingenstein* case, which followed the *Johnston* case, and preferred to restrict its scope rather than overrule it in a case which did not present the same narrow issue.

The Government has not applied for certiorari in the *Craik* case, although before the time for such application had expired, petitioner had asserted a conflict between the decision below and the *Craik* case, in support of the petition for certiorari here. Presumably, therefore, as to partnership income from foreign sources, the Government still adheres to the view expressed in G. C. M. 13771, XIII-2 C. B. 229, *supra* p. 22, and to the general principle of the *Coulby* case upon which that ruling was based.

To summarize: Taxation of partnership income since 1913 has been guided by the general principle that items of partnership income retain their character on partners' returns, whether or not the statute so provides. Section 23(r) of

the 1932 Act was not intended to change this principle. Hence, petitioner is entitled to the claimed offset.

But if there be any uncertainty as to the construction of the statute, it should be resolved in petitioner's favor to avoid the grave constitutional doubts presented by a contrary construction.

POINT II.

Section 23(r) of the Revenue Act of 1932 is unconstitutional if construed to deny to petitioner offset of his non-capital security losses against his distributive share of partnership non-capital security gains, petitioner being engaged in the business of trading in securities for his own account and for his partnership.

If the Court holds that Section 23(r) prevents the offset of petitioner's non-capital security losses against his share of his partnership's non-capital security gains, the Section is arbitrary and discriminatory in violation of the due process clause of the Fifth Amendment,* since it deprives petitioner of the offset merely because (1) his non-capital security gains were earned through a partnership, and (2) he traded in stocks and bonds as distinguished from other speculative media.

---

* This Court has intimated that an income tax law may be so arbitrary and discriminatory as to violate the Fifth Amendment. *Brushaber* v. *Union Pacific R. R.*, 240 U. S. 1, 24; *Barclay & Co.* v. *Edwards*, 267 U. S. 442, 450; *Denman* v. *Slayton*, 282 U. S. 514, 520; *Reinecke* v. *Smith*, 289 U. S. 172, 177.

The court below in *Davis* v. *United States,* 87 F. (2d) 323, cert. den. 301 U. S. 704,* upheld the constitutionality of Section 23(r) in a case where the taxpayer, a casual investor, sought to offset non-capital security losses from isolated transactions against ordinary income which did not include non-capital security gains, saying (pp. 324, 325):

> It will be well to note at the start that our scheme of income taxation provides for a method of computation whereby all receipts during the taxable period which are defined as gross income are gathered together and from the total are taken certain necessary items like cost of property sold; ordinary and necessary expenses incurred in getting the so-called gross income; depreciation, depletion, and the like in order to reduce the amount computed as gross income to what is in fact income under the rule of *Eisner* v. *Macomber,* 252 U. S. 189, and so lawfully taxable as such. In this way true income is ascertained by taking from gross income as defined that which is necessary as a matter of actual fact in order to determine what as a matter of law may be taxed as income. While such subtractions are called deductions, as indeed they are, they are not to be confused with deductions of another sort like personal exemptions; deductions for taxes paid; losses sustained in *unrelated* transactions and other like privileges which Congress has seen fit to accord to income taxpayers

---

* The *Davis* case was followed by the Court of Claims on similar facts in *Cohn* v. *United States,* 23 F. Supp. 534. *In Winmill* v. *Commissioner,* 93 F. (2d) 494, the Government argued that the question whether Section 23(r) is constitutional as applied to a trader was not presented since the Board of Tax Appeals had not found that Winmill was a security trader (Gov. Br. pp. 22-3). The Second Circuit followed the *Davis* case without discussion of the constitutional question presented by petitioner here.

under classifications it has established. While the first kind of deductions are inherently necessary as a matter of computation to arrive at income, the second may be allowed or not in the sound discretion of Congress; the only restriction being that it does not act arbitrarily so as to set up in effect a classification for taxation so unreasonable as to be a violation of the Fifth Amendment. Such deductions as distinguished from the first kind are allowed by Congress wholly as a matter of grace. * * *

The loss which the appellant tried to deduct from his *unrelated* income falls within the second class of deductions of which mention has been made, and so its limitation as in section 23(r) was one which Congress could control in its sound discretion without in substance levying a direct tax without apportionment. (Italics supplied.)

The basis of this decision was that the losses were unrelated to taxpayer's income. Davis was not engaged in the business of trading in securities, nor was he entitled to a distributive share of partnership non-capital security profits in excess of his own non-capital security losses. Since this petitioner's security losses and his share of partnership security gains came from a single business, they were related, and under the reasoning of the *Davis* case, the application of the statute here is unconstitutional.

Discrimination Against Petitioner Because His Profits Were Realized in Partnership Is Unconstitutional.

The constitutional test which must be met by a Federal tax law has been recently defined by this Court as follows:

Congress may adopt a measure reasonably calculated to prevent avoidance of a tax. The test of validity in re-

> spect of due process of law is whether the means adopted are appropriate to the end. * * * But if the means are unnecessary or inappropriate to the proposed end, are unreasonably harsh or oppressive, when viewed in the light of the expected benefit, or arbitrarily ignore recognized rights to enjoy or to convey individual property, the guarantee of due process is infringed. (*Helvering* v. *City Bank Farmers Trust Co.*, 296 U. S. 85, 90.)

Thus the question is whether the application of Section 23(r) to the facts here presented bears a reasonable relationship to the purpose of its enactment.

Had petitioner realized individually his share of his firm's non-capital security gains, the setoff which he is seeking would be allowed without question. Since the setoff has been denied, petitioner is discriminated against merely because his profits were realized in partnership, rather than individually.

Such discrimination bears no relationship to the object of Section 23(r). We have already demonstrated that the sole purpose of Section 23(r) was to prevent the deduction of speculative security losses from salaries, dividends, rents, interest and other similar income. *Supra*, pp. 24-27. There was no intention to deprive partners of the right to offset individual speculative security losses against distributive shares of partnership speculative security gains.

But even if such intention be assumed, we submit that a discrimination against partners in the application of Section 23(r) is so arbitrary and unreasonable as to be unconstitutional. There can be no possible justification for such unequal treatment.

The discrimination is all the more unfair because petitioner realized the profits and sustained the losses in the course of his single business of trading in securities. To segregate the profits from such single business and subject them to special taxation merely because they were derived through a partnership is highly arbitrary.

Further, petitioner had no notice at any time during the tax year 1932 that the continued conduct of part of his business through the medium of a partnership would result in additional taxes. This is not a case where there was an established policy of Congress, knowledge of which was chargeable to the taxpayer. On the contrary, the long established policy of Congress accorded to persons doing business in partnership the same right of taking deductions against partnership income as though the business were conducted individually. *Craik* v. *United States,* 31 F. Supp. 132, 135, quoted *supra,* p. 39.

Discrimination Against Petitioner Because His Business Was Trading in Corporate Securities Is Unconstitutional.

Section 23(r) does not apply to all speculative transactions, but only to transactions in assets defined in Section 23(t), which limits the operation of the Section to stocks and bonds held less than two years, except Government securities. The court in the *Davis* case did not discuss the discrimination against traders in stocks and bonds, but said only that Congress was justified in restricting the availability of security losses against ordinary income to losses on securities held more than two years.

The discriminatory effect of the special treatment of stocks and bonds is illustrated by a series of hypothetical cases:

A, a trader in United States Government bonds, bought $100,000 of such bonds at par in 1931 and sold them for $95,000 in 1932. The $5,000 loss is deductible from ordinary income (I. T. 2672, XII-1 C. B. 72, 73).

B, a trader in foreign government bonds, bought $100,000 of such bonds at par in 1931 and sold them for $95,000 in 1932. The $5,000 loss is deductible from ordinary income (I. T. 2671, XII-1 C. B. 41).

C, a real estate trader, bought a parcel in 1931 for $100,000 and sold it in 1932 for $95,000. The $5,000 loss is deductible from ordinary income (I. T. 2671, XII-1 C. B. 41, 43).

D, a trader in commodity futures, bought wheat contracts in 1931 for $100,000 and sold them in 1932 for $95,000. The $5,000 loss is deductible from ordinary income (I. T. 2774, XIII-1 C. B. 62).

E, a trader in mortgages, bought one in 1931 for $100,000 and sold it in 1932 for $95,000. The $5,000 loss is deductible from ordinary income (I. T. 2671, XII-1 C. B. 41, 43).

F, a trader in corporate stocks and bonds, bought a block of such securities in 1931 for $100,000 and sold them in 1932 for $95,000. The loss of $5,000 is not deductible from ordinary income, and not deductible at all unless F had realized gains of $5,000 from transactions in such securities held less than two years, in which case the loss of $5,000 may be offset against the gains.

In each of the first five cases, the trader is permitted to recoup his loss in part by taking a [illegible] deduction with resultant tax saving. In the sixth c[illegible]he stock and bond trader is not permitted such reco[illegible]nt.

Except perhaps in the case of Government bonds, there is no justification for this discrimination, since in each of the six cases the taxpayer is a speculator as defined by the Senate Finance Committee which drafted Section 23(r) (*supra,* pp. 25-26), having held the asset for less than two years.

In the case of A, the trader in Government bonds, the discrimination was deliberate. The reason was given by the Ways and Means Committee (72nd Cong., 1st Sess., H. Rept. 708, p. 13):

> Federal, State, and municipal bonds are excluded from the definition so as not to hamper the sales of such securities. Bonds of foreign governments are also excluded.

The desire to facilitate sale of Government bonds may justify the exclusion of Government bonds from a loss-limiting provision. But even in this respect, Section 23(r) is capricious, since it taxes a Government bond trader on profits although he has losses on other securities held less than two years. *Charles J. Bradley,* 41 B. T. A. 153. In this situation, instead of facilitating the sale of Government bonds, the statute singles out Government bond profits for taxation despite losses on securities held the same length of time which are deductible from corporate security profits.

But the desire to facilitate the sale of Federal, State and municipal bonds does not justify the exemption of the trader in foreign government bonds. There is no reason why a salaried person may reduce the tax on his salary by losses in an unsuccessful speculative venture in foreign government bonds, but not by losses on sales of American corporate securities.

There is also no justification for discriminating in favor of D, the trader in commodity futures. It does not appear that Congress desired to favor speculators in commodity futures as against speculators in corporate securities. On the contrary, the congressional policy to discriminate against commodity traders by tax measures was announced as early as 1913. 63rd Cong., 1st Sess., S. Rept. 80, 1939-1 C. B. (Part 2) 5; Cotton Futures Act (1914), 38 Stat. 693, 26 U. S. C. A. §1920.

Nor is the discrimination against F justifiable on the ground that speculative stock losses constituted a menace to the revenue. During the depression, deduction of huge speculative losses from dealings in real estate, mortgages and commodity futures, constituted no less a menace.

It is also obvious that, as a matter of administration, provisions limiting the deductibility of losses from speculative transactions not involving stocks and bonds would have created no greater problem than did Section 23(r).

Indeed, Section 23(r) was in force for only two years, 1932 and 1933. Between 1924 and 1932, dealings in all types of assets held similar lengths of time were on an equal footing. Section 117 of the Revenue Act of 1934 restored equality of treatment to all types of assets, and this has continued to be the rule under the later Acts, except that since 1938 somewhat more liberal treatment has been accorded to depreciable assets used in business.

Thus, in dealing with the discrimination directed by the 1932 Act against traders in stocks and bonds, the Court is dealing, not with an established legislative policy of long standing, but with a new and experimental provision, abandoned after only two years of operation.

Constitutional questions are questions of degree. The question is whether the denial of the offset on the facts of this case is so unreasonable and unjustified as to shock one's sense of fairness. In judging this question, we submit that it is of vital importance that petitioner was engaged in the business of trading in securities. It is arbitrary beyond the bounds of reasonableness to tax a trader on his income from one phase of his business without allowing deduction of his losses from another phase of the same business where both profits and losses resulted from the same type of activity, security trading, and where the announced policy is to permit the offset of such losses to individuals, on the one hand, and to permit unlimited deduction to traders in all types of assets other than corporate securities, on the other.

If the Court holds Section 23(r) unconstitutional, petitioner is entitled to deduct his individual non-capital security losses under Section 23(e)(1) of the Revenue Act of 1932, permitting deduction of losses incurred in trade or business.

CONCLUSION.

The decision below resulted from the refusal of the court to recognize the principle which has been basic in taxation of partnership income since 1913, namely, that partnership income may be traced to its source behind the partnership for the tax purposes of the individual partners whether or not the statute specifically so provides. Section 23(r), on which the court relied, was enacted for a specific purpose and was not intended to change this principle. The construction adopted by the court below was therefore wrong.

Construed as it was by that court, Section 23(r) exceeds the limits of reasonableness and enters the area of arbitrary action proscribed by the Fifth Amendment.

The decision below should be reversed.

Respectfully submitted,

WALTER MENDELSOHN
WILBUR H. FRIEDMAN
JACOB P. ARONSON

September, 1940.

APPENDIX.

Statutes Involved.

Section 8(e) of the Revenue Act of 1916 provides in part:

> Persons carrying on business in partnership shall be liable for income tax only in their individual capacity, and the share of the profits of the partnership to which any taxable partner would be entitled if the same were divided, whether divided or otherwise, shall be returned for taxation and the tax paid under the provisions of this title: *Provided,* That from the net distributive interests on which the individual members shall be liable for tax, normal and additional, there shall be excluded their proportionate shares received from interest on the obligations of a State or political or taxing subdivision thereof, and upon the obligations of the United States and its possessions, and all taxes paid to the United States or to any possession thereof, or to any State, county, or taxing subdivision of a State, and that for the purpose of computing the normal tax there shall be allowed a credit, as provided by Section 5, subdivision (b), for their proportionate share of the profits derived from dividends.

The Revenue Act of 1932 provides in part as follows:

> Sec. 22. Gross income. * * *
>
> (b) Exclusions from gross income.—The following items shall not be included in gross income and shall be exempt from taxation under this Title. * * *
>
> (4) Tax free interest.— * * * In the case of obligations of the United States issued after September 1,

1917 (other than postal savings certificates of deposit), the interest shall be exempt only if and to the extent provided in the respective acts authorizing the issue thereof as amended and supplemented, and shall be excluded from gross income only if and to the extent it is wholly exempt to the taxpayer from the taxes imposed by this title;

[Section 22(b)(4) of the 1928 Act was similar.]

Sec. 23. Deductions from gross income.

In computing net income there shall be allowed as deductions:

* * * * *

(e) Losses by individuals.—Subject to the limitations provided in subsection (r) of this section, in the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) If incurred in trade or business; or

(2) If incurred in any transaction entered into for profit, though not connected with the trade or business; * * *.

(r) Limitation on stock losses.—

(1) Losses from sales or exchanges of stocks and bonds (as defined in subsection (t) of this section) which are not capital assets (as defined in section 101) shall be allowed only to the extent of the gains from such sales or exchanges (including gains which may be derived by a taxpayer from the retirement of his own obligations).

(2) Losses disallowed as a deduction by paragraph (1), computed without regard to any losses sustained during the preceding taxable year, shall, to an amount not in excess of the taxpayer's net income for the taxable year, be considered for the purposes of this title as losses sustained in the succeeding taxable year from sales or exchanges of stocks or bonds which are not capital assets.

(3) This subsection shall not apply to a dealer in securities (as to stocks and bonds acquired for resale to customers) in respect of transactions in the ordinary course of his business, nor to a bank or trust company incorporated under the laws of the United States or of any State or Territory, nor to persons carrying on the banking business (where the receipt of deposits constitutes a major part of such business) in respect of transactions in the ordinary course of such banking business. * * *

(t) Definition of Stocks and Bonds.—

As used in subsections (r) and (s), the term "stocks and bonds" means (1) shares of stock in any corporation, or (2) rights to subscribe for or to receive such shares, or (3) bonds, debentures, notes, or certificates or other evidences of indebtedness, issued by any corporation (other than a government or political subdivision thereof), with interest coupons or in registered form, or (4) certificates of profit, or of interest in property or accumulations, in any investment trust or similar organization holding or dealing in any of the instruments mentioned or described in this subsection, regardless of whether or not such investment trust or similar organization constitutes a corporation within the meaning of this Act.

Sec. 101. Capital net gains and losses. * * *

(c)(8) "Capital assets" means property held by the taxpayer for more than two years (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business. * * *

[Sections 101(c)(8) of the 1928 Act, and 208(a)(8) of the 1924 and 1926 Acts, were similar.]

Sec. 143. Withholding of tax at source.

(a) Tax free covenant bonds.—

(1) Requirement of withholding.—In any case where bonds, mortgages, or deeds of trust, or other similar obligations of a corporation contain a contract or provision by which the obligor agrees to pay any portion of the tax imposed by this title upon the obligee, or to reimburse the obligee for any portion of the tax, or to pay the interest without deduction for any tax which the obligor may be required or permitted to pay thereon, or to retain therefrom under any law of the United States, the obligor shall deduct and withhold a tax equal to 2 per centum of the interest upon such bonds, mortgages, deeds of trust, or other obligations, whether such interest is payable annually or at shorter or longer periods, if payable to an individual, a partnership, * * *

(d) Income of recipient.—Income upon which any tax is required to be withheld at the source under this section shall be included in the return of the recipient of such income, but any amount of tax so withheld shall

be credited against the amount of income tax as computed in such return.

[Section 144(a)(1) and (d) of the 1928 Act was similar.]

Supplement F of the 1928 and 1932 Acts, entitled "Partnerships," provides in part:

Sec. 181. Partnership Not Taxable.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

Sec. 182. Tax of Partners.

(a) *General Rule.*—There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year. * * * [Provisions dealing with partnership fiscal years are omitted.]

Sec. 183. Computation of Partnership Income.

The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except that the so-called "charitable contribution" deduction provided in section 23(n) shall not be allowed.

Sec. 184. Credits Against Net Income.

The partner shall, for the purpose of the normal tax, be allowed as a credit against his net income, in addition to the credits allowed to him under section 25, his proportionate share of such amounts of dividends and

interest specified in section 25(a) and (b) as are received by the partnership.

Sec. 185. Earned Income.

In the case of the members of a partnership the proper part of each share of the net income which consists of earned income shall be determined under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary and shall be separately shown in the return of the partnership and shall be taxed to the member as provided in this Supplement.

Sec. 186. Capital Net Gains and Losses.

In the case of the members of a partnership the proper part of each share of the net income which consists, respectively, of ordinary net income, capital net gain, or capital net loss, shall be determined under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary, and shall be separately shown in the return of the partnership and shall be taxed to the member as provided in this Supplement, but at the rates and in the manner provided in section 101(a) and (b), relating to capital net gains and losses.

Sec. 187. Net Losses.

The benefit of the special deduction for net losses allowed by Section 117 shall be allowed to the members of a partnership under regulations prescribed by the Commissioner with the approval of the Secretary.

Sec. 188. Taxes of Foreign Countries and Possessions of United States.

The amount of income, war-profits, and excess-profits taxes imposed by foreign countries or possessions of the United States shall be allowed as a credit against the

tax of the member of a partnership to the extent provided in Section 131.

Sec. 189. Partnership returns.

Every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this title, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.

Supplement H—Non-resident alien individuals:

Sec. 211. Normal tax.

(a) *General rule.*—In the case of a non-resident alien individual who is not a resident of a contiguous country, the normal tax shall be 8% of the amount of the net income in excess of the credits against net income allowed to such individual. * * *

Sec. 212. Gross income.

(a) *General rule.*—In the case of a non-resident alien individual gross income includes only the gross income from sources within the United States.

[Sections 211 and 212 of the 1928 Act were similar.]

The Revenue Act of 1934 provided in part:

Sec. 113. Adjusted basis for determining gain or loss.

(a) Basis (unadjusted) of property.—The basis of property shall be the cost of such property; except that—

(13) Partnerships.—If the property was acquired, after February 28, 1913, by a partnership and the basis is not otherwise determined under any of the paragraphs (1) to (12), inclusive, of this subsection,

then the basis shall be the same as it would be in the hands of the transferor, * * *.

Sec. 117. Capital gains and losses. [Identical with Sec. 117(b) of the 1936 Act.]

* * * * *

(b) Definition of capital assets.—For the purposes of this title, "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

The Revenue Act of 1938 provided in part:

Sec. 117. Capital gains and losses.

(a) Definitions.—As used in this title—

(1) Capital Assets.—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l); * * *.

(2) Short-Term Capital Gain.—The term "short-term capital gain" means gain from the sale or exchange of a capital asset held for not more than 18 months, * * *.

(4) Long-Term Capital Gain.—The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 18 months, * * *."

FILE COPY

Office - Supreme Court, U. S.
FILED
OCT 16 1940
CHARLES ELMORE CROPLEY
CLERK

No. 5

Supreme Court of the United States

HARRY H. NEUBERGER,

Petitioner,

—*against*—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR PETITIONER

WALTER MENDELSOHN
WILBUR H. FRIEDMAN
JACOB P. ARONSON

October, 1940.

New York Appeals Co. Inc. 38 Ferry St.

INDEX

PAGE

Reply Brief for Petitioner 1

I. Petitioner's proof of the general principle 2

II. The Government's attempted disproof of the general principle 5

A. The partnership as a net income computing unit 5

B. The argument that petitioner seeks an "additional deduction" 7

C. The argument that under petitioner's view sections of the 1932 Act are surplusage ... 8

D. The Government's authorities 8

E. The Government's discussion of petitioner's authorities 9

III. The Government's suggestion concerning allocation of expenses 10

IV. The Government's failure to meet petitioner's challenge as to the meaning of Section 23(r) as supported by later enactments 13

A. The Government's argument based on the converse situation 13

B. The Government's attack on the force of the 1938 Act and Section 218(d) 15

V. The constitutionality of Section 23(r) 20

Conclusion 21

PAGE

TABLE OF CASES CITED:

Albert K. Miller, 40 B. T. A. 514 18
Ardenghi v. Helvering, 100 F. (2d) 406 ..... 13n

Brushaber v. Union Pacific R. R., 240 U. S. 1, 24-5 ... 20

Craik v. United States, 31 F. Supp. 132 .....1, 9, 11

Denman v. Slayton, 282 U. S. 514, 520 20

Helvering v. Clifford, 309 U. S. 331 8

Jennings v. Commissioner, 110 F. (2d) 945 .....3, 7, 9, 11
Johnston v. ~~United States~~ Commissioner, 86 F. (2d) 732 15

Lord Forres, 25 B. T. A. 154 8

New York Trust Co. v. Eisner, 256 U. S. 345, 349 2

Shearer v. Burnet, 285 U. S. 228 8

United States v. Coulby, 258 Fed. 27, affirming 251 Fed. 982 .....2, 9, 10, 11

W. J. Burns, 12 B. T. A. 1209 8
Woolford Realty Co. v. Rose, 286 U. S. 319 13

STATUTES AND OTHER AUTHORITIES CITED:

	PAGE
Revenue Act of 1916	
Section 8(e)	2
Revenue Act of 1932	
Section 143(d)	4
Section 22(b)(4)	5
Section 183	5, 15
Section 182	6, 14
Section 184	6, 8
Section 185	6, 8
Section 186	6, 8, 18
Section 23(r)	7, 13, 15, 18
Section 188	8
Section 187	14
Section 23(r)(2)	15, 19
Section 23(t)	18
Section 23(r)(1)	19
Revenue Act of 1913	
Section D	9
Revenue Act of 1934	
Section 184	11n
Revenue Act of 1936	
Section 184	11n
Revenue Act of 1938	
Section 184	11n
Section 183	17
~~Section 218(d)~~	~~18~~
Revenue Act of 1918	
Section 218	15
Section 218 of Acts of 1921, 1924 and 1926	15n

PAGE

Section 183 of 1928 Act 15n

National Industrial Recovery Act
Section 218(d) 18, 19

Committee Report (73rd Cong., 1st Sess., S. Rept. 114, p. 7) 18

Art. 30 (Par. 213) Regs. 33 (1916 Act) 14
Art. 332, Regs. 62 (1921 Act) 14
Art. 336 of Regs. 65 (1924 Act) 14
Art. 336 of Regs. 69 (1926 Act) 14
Art. 902 of Regs. 74 (1928 Act) 14
Art. 902 of Regs. 77 (1932 Act) 14
Art. 182-1(b) of Regs. 86 (1934 Act) 14
Art. 182-1(b) of Regs. 94 (1936 Act) 14
Art. 183-1 of Regs. 86 (1934 and 1936 Acts) 14
Art. 183-1 of Regs. 94 (1934 and 1936 Acts) 14
Art. 261(e) of Regs. 77 (1932 Act) 15
Art. 251 of Regs. 45 (1918 Act) 15n
Art. 62 (1921 Act) 15n
Art. 65 (1924 Act) 15n
Art. 69 (1926 Act) 15n
Art. 261 (1928 Act) 15n

G. C. M. 18120 ..... 4, 12
O. D. 593 8
G. C. M. 13771, XIII-2 C.B. 229 (1934) 10, 17n
A. R. M. 13, 2 C.B. 168 (1920) 11n, 12

Supreme Court of the United States

HARRY H. NEUBERGER,

Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR PETITIONER

The Government has failed to disprove the existence of the principle that partnership income retains its character on individual partners' returns. We have demonstrated that such principle has controlled the taxation of partnership income in all the Revenue Acts since 1913.

The Government urges the existence of a statutory "scheme" following a pattern established in 1918, said to be inconsistent with such principle (Gov. Br. 5, 10). It cites not a single instance (except the case at bar) in which such "scheme" has been applied to prevent items of partnership income from retaining their character on partners' returns.

This is not the scheme which the Government had in mind in November, 1939, when, in its brief in the *Craik* case, it

felt called upon to apprise the Court of Claims that the rule of the *Coulby* case had been accepted by the Treasury in most instances as the law under subsequent Revenue Acts (Pet. Br. 15).

The fact is that the courts, the Congress, and (in three instances where the statute was silent) the Treasury have all applied the principle for which we contend.

The Government ignores the historical development of this principle. It disregards Mr. Justice Holmes' admonition that in the interpretation of a tax statute "a page of history is worth a volume of logic." *New York Trust Co.* v. *Eisner*, 256 U. S. 345, 349. Finally, its argument is shot through with fallacies.

I.

Petitioner's proof of the general principle.

The Government either ignores or concedes the following significant points:

1. The first provision in any Revenue Act (Section 8(e) of the 1916 Act dealing with dividends and Government bond interest), which specifically provided that an item of partnership income retained its character on partners' returns, was inserted to make clear Congress' disapproval of the Treasury's erroneous interpretation of the 1913 Act (Pet. Br. 11-13).

2. The Treasury consistently ruled in a variety of situations over the sixteen year period from 1919 to 1935 that items of partnership income retain their character on partners' returns in the absence of statutory provision (Pet. Br. 14).

3. The Treasury has continued to apply this general rule since 1935, except in the two cases of partnership non-capital security profits under the 1932 Act and partnership gambling gains under the 1936 Act (Pet. Br. 19-23). The latter ruling has been rejected by the Fifth Circuit, *Jennings* v. *Commissioner,* 110 F. (2d) 945, which case the Government concedes is contrary to its contention here (Gov. Br. 35n).

4. There has never been a provision in any Revenue Act denying to a partner the right to treat items of partnership income as retaining their character on his return.

5. Every provision in every Revenue Act which has dealt with the treatment of specific items of partnership income on partners' returns has directed that such items retain their character.

6. Except in the situation at bar, the courts have treated items of partnership income as retaining their character in partners' hands (Pet. Br. 34-40).

The Government also concedes that the Treasury's treatment of the foreign income of a domestic partnership (which we cite, Pet. Br. 19-23, as one of three instances in which the Treasury has filled gaps in the statute by applying the general principle) is contrary to its contention here (Gov. Br. 29). While the Government seeks to explain the other two instances on other grounds (Gov. Br. 27, 30 and *infra* pp. 4-5), it attempts to dispose of all three by arguing that the retention of their character on partners' returns does not modify the "scheme" of the Act for computing partnership net income.

The argument is that while the general principle urged by petitioner is inconsistent with what the Government con-

ceives to be the "scheme" of the Act for computing partnership net income, the three cited applications of that principle are not inconsistent with that "scheme." But if three applications of the principle that partnership items retain their character on partners' returns do not modify the scheme of the Act for computing partnership net income, there is no reason why the same treatment of a fourth item, partnership non-capital security gains, should be deemed to modify that scheme. In all four instances, the fact is that the item is taken into account in computing the partnership's net income, but its character as a particular kind of income controls in determining how that item of partnership net income shall affect the individual partner's tax.

The ruling permitting the carry-over of the 2% tax withheld at source on certain partnership bond interest is said to rest on the Treasury's desire to avoid double tax (Gov. Br. 27-8). But this is no answer. Under Section 143(d) of the 1932 Act, the credit is allowed only against the income tax "of the recipient of such income." Thus, whatever the hardship, it is impossible to arrive at the Treasury's result unless the partner's share of the partnership's bond interest income is treated as his income. Since there is no provision in the statute authorizing such treatment, the only way to reach the Government's result is by applying the general rule for which petitioner contends. G. C. M. 18120, which so holds, is all the more significant because there the partnership had no net income; nevertheless the General Counsel said that the partnership's bond interest was "included" in the individual partner's return and therefore met the requirement of Section 143(d) (Pet. Br. 21).

As to Government bond interest, the Government concedes that, in the absence of any statutory provision to that effect, the Treasury gives a partner exemption from

surtax as if he owned directly a proportionate part of the bonds owned by the partnership (Gov. Br. 30), but says that this does not modify the method of computing partnership net income.

Obviously, the Treasury Regulation modifies the method of computing partnership net income no less and no more than would the separate treatment of partnership non-capital security gains urged by petitioner. The interest on Government bonds owned by the partnership in a principal amount exceeding $5,000 is included in the partnership's gross income under Section 22(b)(4) of the 1932 Act and hence is reflected in its net income under the statutory scheme for computing the partnership's income. After that net income is determined, it is necessary under the Treasury Regulation to go behind that net income for the purpose of determining how much of that net income is interest on each partner's proportionate share of Government bonds. If it is consistent with the statutory scheme to go behind the partnership net income for the purpose of segregating Government bond interest, it is likewise consistent with that scheme to go behind the partnership net income for the purpose of segregating partnership non-capital security gains.

II.

The Government's attempted disproof of the general principle.

A. The partnership as a net income computing unit.

The Government's major attack* on the principle we invoke is (Gov. Br. 12-17, 21, 26) that Section 183 requires

* A subsidiary attack based on an assumed need for allocation of expenses (Gov. Br. 15) is disposed of in Point III *infra*.

partnership net income to be computed as though a partnership were an entity; that the partners' distributive shares of such net income must be carried over into their returns under Section 182; and that it would violate the statutory scheme if thereafter the partners could break down the partnership income into its component parts.

But the partnership net income as computed under Section 183 is not an indestructible entity. The statute itself provides that four items which have been included in partnership net income shall be segregated therefrom for separate treatment on partners' returns: dividends (Section 184), Government bond interest for normal tax purposes (Section 184), earned income (Section 185) and capital gains (Section 186). In three other cases, where the statute is silent, the Treasury has voluntarily permitted partners to segregate items of partnership gross income from partnership net income for special treatment. These are Government bond interest for surtax purposes (Pet. Br. 19 and *supra* p. 4), partnership bond interest upon which a tax has been withheld at the source (Pet. Br. 20 and *supra* p. 4), and partnership income from foreign sources (Pet. Br. 22 and *supra* p. 3).

The Government argues that, if petitioner may segregate partnership non-capital security gains from his share of partnership net income, all items of partnership income and deductions may be so segregated on partners' returns (Gov. Br. 13). This possibility is viewed by the Government with unnecessary alarm. In effect a partner always takes over his proportionate share of each item of partnership income and deduction, despite the fact that the result may be reported on his return as a single figure. Only when a particular kind of partnership income is singled out by the statute for special treatment is segregation important.

If the Government's argument is sound, the three Treasury rulings on 2% covenant bond interest, Government bond interest for surtax purposes and foreign income of a domestic partnership (all of which are still in force) are unsound.

Nor is petitioner taking a prohibited deduction from net income instead of from gross income (Gov. Br. 12). A partner's distributive share of partnership net income appears on his return as an item of his gross income (R. 15). We seek only to segregate one of the component items of the partnership income, non-capital security gains. This is done by the 1938 Act with respect to partnership short-term (i.e., non-capital) security gains, *infra* pp. 15-18, and this was also done by the courts, Congress and the Treasury with respect to other items of partnership income under the 1932 and other Acts.

B. The argument that petitioner seeks an "additional deduction."

The Government erroneously contends that petitioner is seeking a deduction in addition to those authorized by the statute (Gov. Br. 10, 28) and that, as deductions are a matter of grace, they should not be allowed unless clearly authorized by the statute (Gov. Br. 7, 36). But Section 23(r) does allow the deduction of non-capital security losses against non-capital security profits, the only question being whether petitioner's share of his partnership's non-capital security profits may be regarded as his for the purposes of the statute. The answer to this question depends on whether petitioner is correct that there is a general rule that items of partnership income retain their character on partners' returns. The Government's reference to an "additional deduction" begs the whole question in this case. The "additional deduction" argument was rejected by the Fifth Circuit in the *Jennings* case, 110 F. (2d) at 946.

C. The argument that under petitioner's view sections of the 1932 Act are surplusage.

The Government urges that the specific provisions in Sections 184, 185, 186 and 188 are surplusage under the petitioner's argument (Gov. Br. 17, 26). In *Helvering* v. *Clifford,* 309 U. S. 331, the shoe was on the other foot. There the taxpayer contended that since Congress had made specific provision for taxing particular kinds of trust income to the settlor, there was no general rule that the settlor could be taxed on trust income in other situations. The Government successfully urged that the fact that Congress had defined with particularity certain instances in which the general rule applied did not contract the scope of the general rule. The surplusage argument is even weaker here than it was there since the express reference to particular types of income in the partnership sections stems directly from the Treasury's original erroneous interpretation of the 1913 Revenue Act.

D. The Government's authorities.

The *Menken, Kurzman* and *Wilson* cases and O. D. 593 (Gov. Br. 22-24) held only that a partner may not deduct on his individual return items which his partnership had or could have deducted on its return. Presumably the individual partner had already benefited from these deductions in the computation of his distributive share of the partnership income or loss. These cases do not present the question whether an item of partnership income or deduction retains its character on the partners' returns. We have already dealt with the *Burns* and *Forres* cases (Pet. Br. 23n).

In *Shearer* v. *Burnet,* 285 U. S. 228 (Gov. Br. 22-23), the question was whether a partner reporting in his calendar

year return for 1924, partnership income for the fiscal year ended April 30, 1924, was entitled to reduction of 25% of the tax on any part of such partnership income. The Court pointed out that, under the statute, the 25% reduction applied only to income reported for the calendar year 1923. Presumably the partners had already received the benefit of the reduction on the partnership income for the fiscal year ended in 1923. To have accepted Shearer's contention would have contravened the express language of the statute and the congressional purpose to permit a reduction with respect to tax for a period of twelve months only. The *Colip* case involved the same point. These cases neither presented nor discussed the question here.

E. The Government's discussion of petitioner's authorities.

Petitioner cited three cases holding that items of partnership income retain their character on partners' returns in the absence of statutory provision. The Government concedes that the *Jennings* and *Craik* cases support petitioner's view (Gov. Br. 29, 35n), but erroneously says the holding in the *Craik* case was limited to the narrow issue before the court. On the contrary, the Court of Claims adopted the general rule urged by petitioner, and even went out of its way to state that an individual should have every deduction from partnership income which he might take from his individual income (Pet. Br. 37-40). The rule thus stated requires the allowance of the offset sought by petitioner.

The Government attempts three explanations of the *Coulby* case (Gov. Br. 33-34):

(1) It is said to rest upon the specific provisions of the 1913 Act, but no provision of the 1913 Act is cited.

(2) It is said that that Act required no partnership return. But the Commissioner was authorized by Section D

to require a return. In any event, as the partnership return is merely an information return, it is immaterial whether one was required from all partnerships, since the 1913 Act (like the later statutes) required partners to report their distributive shares of partnership net income.

(3) It is said that the *Coulby* decision was in accordance with the provision in the 1916 Act specifically allowing a deduction by individual partners, and that that provision was a legislative recognition of the intent of the 1913 Act. That is precisely our contention as to the effect of the 1938 Act in this case (Pet. Br. 33-34).

All three attempts to explain the *Coulby* case run counter to the Treasury's acceptance of that decision for sixteen years as controlling under later Acts, including the 1928 Act, the partnership provisions of which were identical with the 1932 Act (G. C. M. 13771, XIII-2 C. B. 229 (1934), Pet. Br. 22).

III.

The Government's suggestion concerning allocation of expenses.

The Government suggests that petitioner should have made an allocation of partnership expenses to the firm's non-capital security gains* (Gov. Br. 15). But the Board found (R. 21) that the partnership had a profit from non-capital security transactions of $142,802.29, that its net income was $109,651.06, and that petitioner's distributive share was $36,000 of the first $94,000 and 45% of the excess

---

* This is obviously an afterthought. The point was not presented by the Commissioner's deficiency notice (R. 7-10), nor raised by the Government at any time before it filed its brief on the merits in this Court.

(about $44,000; Gov. Br. 3). On these findings it is clear that all of petitioner's $44,000 share of the partnership net profit may be attributed for the purposes of this case to the firm's non-capital security transactions.

The Government's argument is, in effect, that under the second of two alternative methods of computation, it is necessary to apportion the partnership's business expense deductions between the non-capital gains and other income of the partnership. But it is the first of the alternative methods, requiring no such allocation, which is the established practice. In most, if not all, situations where the principle of treating an item of partnership income as retaining its character on partnership returns is applied, the question is presented whether to allocate any part of the partnership's deductions against such item. Yet such an allocation has never been made. Wherever the statute has made provision for special treatment of items of partnership income on partners' returns, credit has been given to the partners for their *full* proportionate shares of such items without regard to possible expenses and other deductions of the partnership.* This is also the practice which has been followed by the Treasury for 20 years and which was adopted in the *Coulby, Craik* and *Jennings* cases. As the Fifth Circuit said in the *Jennings* case (110 F. (2d) at 946):

> "The partnership return is for information, and to secure uniformity and save repetition in the individual

---

* Except that since 1934 the credit for dividends and Government bond interest (for normal tax purposes) has been limited to the amount of the partnership's net income (Sec. 184 of the 1934, 1936 and 1938 Acts), thus adopting the rule early applied by the Treasury. A. R. M. 13, 2 C. B. 168 (1920).

returns. It ascertains each partner's gain and apportions it to him to be taxed, whether distributed or not. It does not transform his share in the gain."

Under the 1913 Act, which contained no provision for separate treatment of items of partnership income on partners' returns, the Treasury ruled that where a partnership had dividend income and operating losses, the full amount of the net income should be treated as dividend income. A. R. M. 13, 2 C. B. 168 (1920). This ruling is directly in point here, where the operations of the partnership apart from its non-capital security gains resulted in a loss (R. 21). Under this ruling, all of petitioner's $44,000 share of his partnership's net income may be treated as non-capital security gain for the purposes of this case.

In 1937 this rule was extended to the extreme situation where a partnership had a net loss, the Treasury still holding that the item to be specially treated carried over into the partners' returns. G. C. M. 18120 (Pet. Br. 21 and *supra* p. 4).

The correct approach is that which the Treasury has always taken with respect to Government bond interest for surtax purposes (Pet. Br. 19 and *supra* pp. 4-5). The Treasury gives each partner exemption as though he owned directly his proportionate share of the Government bonds owned by the partnership. The Treasury has never suggested that the interest on such proportionate share of Government bonds should be reduced by an allocation thereto of deductions of the partnership, although ordinarily Government bond interest of the partnership would be merged on its books with other income and offset by deductions of the partnership.

No other approach would satisfy the rule that items of partnership income retain their character on partners' returns, since only in this way does the partner obtain the full benefit of the special treatment provided for the particular kind of income in question.

IV.

The Government's failure to meet petitioner's challenge as to the meaning of Section 23(r) as supported by later enactments.

We have challenged the Government to point to anything in Section 23(r), or in the 1932 Act, or in the Committee Reports, showing that Congress intended to prevent the offset of individual non-capital security losses against a partner's share of partnership non-capital security gains (Pet. Br. 25). This challenge stands unanswered, as of necessity it must.

A. The Government's argument based on the converse situation.

Instead of meeting the challenge, the Government has sought indirectly to bolster its interpretation of Section 23(r) as denying the offset in question by reference to the converse situation, i.e. the setoff by partners of their shares of excess non-capital security losses of the partnership against their individual non-capital security gains. The Government assumes that such setoff is not permissible, citing *Woolford Realty Co.* v. *Rose,* 286 U. S. 319* (Br.

---

* *Ardenghi* v. *Helvering,* 100 F. (2d) 406, cited twice (Gov. Br. 15n, 25) has nothing to do with this case.

15n, 25) and Section 187 of the 1932 Act (Br. 25n), and urging that losses disallowed to the partnership are in no event available to the partners. This argument is completely without merit:

1. The *Woolford Realty* case held that, for purposes of the net loss carryover from a preceding year, in the case of corporations filing consolidated returns, the limitation of the carryover to the amount of the "net income" in the succeeding year precluded a carryover by an affiliate having a net loss in the succeeding year. This was in accord with the intent of Congress and the uniform administrative interpretation.

But for 20 years the Treasury has held that "net income" in Section 182 of the 1932 Act and similar sections of other Acts includes "net loss" and that a partner may deduct his share of the partnership current year "net loss" on his return despite the absence of any provision to that effect in the statute. Art. 30 (par. 213), Regs. 33 (1916 Act); Art. 332, Regs. 62 (1921 Act); Art. 336 of Regs. 65 (1924 Act) and 69 (1926 Act); Art. 902 of Regs. 74 (1928 Act) and 77 (1932 Act); Art. 182-1(b) of Regs. 86 (1934 Act) and 94 (1936 Act). See also Art. 183-1 of Regs. 86 and 94, apparently nullifying in part the Congressional purpose under the 1934 and 1936 Acts to deprive partners of the benefit of partnership capital losses.

2. Section 187, dealing with net losses carried over from prior years, has no bearing on the question whether a partner may deduct his share of the partnership's net loss for the current year or whether a partner may take his share of current year partnership losses disallowed to the partnership. Both points are covered by Treasury Regulations expressly applicable to partnerships. Current year net losses

are covered by the Regulations cited in the preceding paragraph. The only current year deduction disallowed to partnerships prior to 1933 was the charitable contribution deduction (Sec. 183, 1932 Act and its predecessors commencing with Sec. 218, 1918 Act*). Under all these Acts the Treasury permitted partners to deduct their shares of the partnership's contributions.**

Art. 261(e) of Regs. 77 (1932 Act) provided:

> His proportionate share of contributions made by a partnership may be claimed as a deduction in the personal return of a partner to an amount which, when added to the amount of contributions made by the partner individually and claimed as a deduction, is not in excess of 15 per cent of the partner's net income computed without the benefit of the deduction for contributions.

By analogy to this treatment of charitable contributions, excess non-capital security losses disallowed to the partnership by Section 23(r) were available to partners under the 1932 Act. So the Senate Finance Committee said in amending the law in 1933, and its statement is supported by Section 23(r) (2) of the 1932 Act (*infra* p. 19).

B. The Government's attack on the force of the 1938 Act and Section 218(d).

In the 1938 Act, the first general Revenue Act following the *Johnston* case, Congress expressly provided that partnership short-term security profits (the equivalent of partner-

---

* Sec. 218, 1921, 1924 and 1926 Acts; Sec. 183, 1928 Act.

** Art. 251 of Regs. 45 (1918 Act), 62 (1921 Act), 65 (1924 Act) and 69 (1926 Act); Art. 261 (1928 Act).

Regs 74

ship non-capital security profits under the 1932 Act) retain their character on partners' returns; thus prospectively voiding the Treasury's ruling in this case. The draftsmen regarded the new section as a logical corollary of the proposition that only partners as individuals, not the partnership as an entity, are subject to tax (Pet. Br. 32-34). The Government makes three attempts to avoid the impact of the 1938 Act upon this case:

(1) It erroneously says that the Committee Report indicates that the new provision represented a change in the law (Gov. Br. 18). The Committee expressly said that it was changing the treatment of partnership security *losses* (Pet. Br. 32-33). It did not say that it was changing the treatment of partnership security *gains*. The specific reference to *gains* was explained as a "logical corollary" of the principle that partnerships are not taxable entities.

(2) The Government erroneously states that the Committee Report supports its contention here (Gov. Br. 20-21). The portion quoted by the Government precedes that quoted by petitioner (Br. 32-33) and is in no way inconsistent with it. The Government's quotation merely states the general rules that the income of a partnership is to be computed in the same manner as that of an individual and that the tax is paid by the partner on his distributive share of the partnership net income. Petitioner's quotation indicates that, despite these general rules and consistently therewith, items of partnership income retain their character on partners' returns. There is nothing in the portion quoted by the Government to indicate Congress' views with respect to the treatment of non-capital partnership security gains under earlier Acts, whereas the portion quoted by petitioner clearly indicates that Congress believed that such gains retained their character on partners' returns under the earlier Acts.

(3) The Government stresses the language of Section 183 of the 1938 Act providing that partnership short-term gains and losses shall be excluded from the computation of partnership net income (Br. 18, 21). There is no magic in the use of the word "exclude." The treatment accorded by the 1938 Act to partnership short-term gains and losses is in substance the same treatment expressly accorded by the earlier Acts to dividends, Government bond interest (for normal tax purposes), earned income and capital gains, and voluntarily accorded by the Treasury to Government bond interest (for surtax purposes), bond interest upon which tax was withheld at source, and income from foreign sources. Under the earlier Acts and Treasury rulings, each of these items was first taken into account in computing partnership net income, and was then segregated for special treatment on the partners' returns.* The effect of such segregation was to exclude these seven items from the partnership net income as shown on the individual partners' returns. Section 183 of the 1938 Act merely describes in express terms the practice followed for 20 years without such express language. Obviously, it is immaterial whether such segregation is made before (as under the 1938 Act) or after (as under

---

*This appears graphically from instruction 5 attached to the 1932 individual income tax return (Form 1040), which said: "Enter as Item 5 your share (whether received or not) of the profits of a partnership, * * * except that the share of (a) capital net gain or loss computed as provided in Instruction 8a shall be reported in Schedule D, (b) taxable interest on obligations of the United States shall be included in Schedule E, and (c) profits which consisted of dividends on stock of domestic corporations shall be included in Item 10 ((a) and/or (b)) on the return. Include in Items 39 and 40, respectively, credits claimed for [partnership] income tax paid at source, and [partnership] foreign income taxes." In addition to the items mentioned in the instructions, income from foreign sources may also be segregated (G. C. M. 13771, XIII-2 C. B. 229).

the earlier Acts and Treasury rulings), the partnership net income is computed.

The Government also makes four attempts to show that Section 218(d) does not support petitioner's contention:

(1) The Government suggests that the Finance Committee Report cited by petitioner (Br. 27-8) may have referred to net losses carried over from prior years (Gov. Br. 30-31). But such net losses were covered by Section 187, which was repealed by Section 218(a) of the National Industrial Recovery Act and explained by a separate portion of the Committee Report (73rd Cong., 1st Sess., S. Rept. 114, p. 7).*

(2) Alternatively, the Government suggests that the Committee Report referred to capital losses and not to non-capital losses (Gov. Br. 31-32). But capital losses were expressly covered by Section 186 and neither the draft of Section 218(d) nor its final form made any reference to Section 186 or to capital losses. The reference in the draft to Section 23(t) shows that the Committee was thinking only of non-capital losses, since Section 23(t) refers to Section 23(r). If the Government were right that the Committee's reference to security losses was to capital losses, then we have the amazing situation of an amendment proposed for the purpose of changing Section 186 (which it never mentioned) and finally enacted for the sole purpose

---

* In a footnote (Gov. Br. 31n) the Government suggests that, despite the repeal of Section 187, Section 218(d) was necessary to prevent the carryover to 1933 of a 1931 net loss under the 1928 Act. This is flatly wrong. Section 1 of the 1932 Act makes that Act applicable to 1932 and succeeding years, and preserves earlier Acts only for earlier years. Section 187 of the 1932 Act (Pet. Br. 56) referred back to Section 117, and under Section 117(d), a 1931 loss could not be carried beyond 1932. Compare *Albert K. Miller*, 40 B. T. A. 514.

of restating what the Government says was the prior law. And this in an emergency measure!

(3) The Government says that Section 218(d) of the National Industrial Recovery Act is declaratory of the 1932 law for the reason that excess partnership non-capital losses were not available to partners in 1932 (Gov. Br. 32). We have already demonstrated (*supra* pp. 13-15) that, by analogy to the Treasury's treatment of charitable contributions, excess partnership non-capital security losses were available to partners. This is confirmed by Section 23(r)(2) *infra* this page.

(4) The Government also refers to the carry-over under Section 23(r)(2) to the succeeding year of excess non-capital losses disallowed by Section 23(r)(1) (Gov. Br. 33). But obviously this carry-over provision has no reference to partnerships. The carry-over is permitted "to an amount not in excess of *the taxpayer's* net income for the taxable year". (Italics supplied.) As the Government has repeatedly pointed out in its brief, a partnership is not a taxpayer; and since the provision is limited by its language only to taxpayers, it is clear that it did not affect partnerships. Section 23(r)(2) meant only that excess non-capital security losses of partnerships, available to partners under the same theory as charitable contributions disallowed by Section 183, were to be carried over to the succeeding year only to the extent not applied by the individual partners in the preceding year (limited to their net incomes for that year).

So far from aiding the Government's argument that Section 218(d) was declaratory, the language of Section 23(r)(2) conclusively demonstrates that, in the absence of Section 218(d), excess partnership non-capital security

losses were deductible by the partners, just as the Committee had said (Pet. Br. 27-8).

V.

The constitutionality of Section 23(r).

The Government's constitutional argument (Br. 37-8) rests on the false premise that, since deductions are matters of legislative grace, petitioner, who has already received the benefit of a deduction specifically allowed, cannot protest that Congress should have been "more generous."

The premise is false for the reason that Congress, in exercising its legislative grace, may not discriminate arbitrarily. *Brushaber* v. *Union Pacific R. R.*, 240 U. S. 1, 24-5; *Denman* v. *Slayton*, 282 U. S. 514, 520. Petitioner has been required to pay a tax on his share of his partnership's non-capital security gains although he has sustained non-capital security losses and although both gains and losses were the fruits of his single security trading business. Hence, he has not received the same benefit from a deduction specifically allowed by Congress as have other taxpayers whose business was speculation in assets other than corporate securities, or who, though speculating in corporate securities, conducted their business as individuals.

This double barreled discrimination is not based on policy considerations or on any reasoned classification. There is nothing in the Committee Reports cited by the Government to justify either discrimination; the only distinction sought to be justified by Congress was that between speculators and investors.

The Government ignores the argument that petitioner is discriminated against because he is a member of a part-

nership, unless the statement that "all taxpayers similarly situated are treated alike" by the statute is intended to be an answer; but the only force of this statement is to point out that there may be other members of partnerships in petitioner's situation. It is no justification of the statute to point out that one group has been unfairly treated without reason grounded on policy considerations or purposeful classification.

None of the Government's cases supports a tax which is arbitrary not only in its classification, but also in singling out profitable transactions for separate taxation despite losses on similar transactions sustained in the same business.

CONCLUSION.

For the reasons set forth above and in petitioner's main brief, the judgment should be reversed.

Respectfully submitted,

WALTER MENDELSOHN
WILBUR H. FRIEDMAN
JACOB P. ARONSON

October, 1940.

FILE COPY

SUPREME COURT, U.S.
FILED
OCT 13 1939
CHARLES ELMORE CROPLEY
CLERK

No. [redacted]

In the Supreme Court of the United States

October Term, 1939

[redacted]

Petitioner,

v.

[redacted]

Respondent.

On Petition for Certiorari to the [redacted]

Petition

INDEX

	Page
Opinions below	1
Jurisdiction	1
Questions presented	2
Statute and regulations involved	2
Statement	3
Argument	4
Conclusion	8
Appendix	9

CITATIONS

Cases:	
Davis v. *United States*, 87 F. (2d) 323, certiorari denied, 301 U. S. 704	7
Helvering v. *Winmill*, 305 U. S. 79	7
Johnston v. *Commissioner*, 86 F. (2d) 732, certiorari denied, 301 U. S. 683	4, 5, 6, 7
Jordan v. *Roche*, 228 U. S. 436	6
Klingenstein v. *United States*, 18 F. Supp. 1015, certiorari denied, 302 U. S. 716	7, 8
United States v. *Coulby*, 258 Fed. 27, affirming 251 Fed. 982	5
Statutes:	
Revenue Act of 1932, c. 209, 47 Stat. 169:	
Sec. 23	9
Sec. 181	11
Sec. 182	11
Sec. 183	11
Sec. 184	11
Sec. 185	12
Sec. 186	12
Sec. 187	12
Sec. 188	12
Sec. 189	13
Revenue Act of 1938, c. 289, 52 Stat. 447, Section 182 (U. S. C. Supp. IV, Title 26, Sec. 182)	5, 7, 13
Miscellaneous:	
Treasury Regulations 77, promulgated under the Revenue Act of 1932:	
Art. 121	13
Art. 282	14

197329—39

BLANK PAGE

In the Supreme Court of the United States

OCTOBER TERM, 1939

No. 548

HARRY H. NEUBERGER, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 20–23) is reported in 37 B. T. A. 223. The opinion of the Circuit Court of Appeals (R. 46–50) is reported in 104 F. (2d) 649.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 29, 1939 (R. 53). The time within which to apply for a writ of certiorari was extended for a period of 60 days from that date by an order signed on

September 26, 1939 (R. 54). The petition for a writ of certiorari was filed on November 21, 1939. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

During the year 1932 the taxpayer was engaged in the business of trading in securities on the floor of the New York Stock Exchange for a partnership of which he was a member and also for his individual account. The commissions upon purchases which the taxpayer made for his own account were paid by him to the partnership and were reflected in the partnership income of which the taxpayer received his distributive share. The questions presented are:

1. Whether, under Section 23 (r) of the Revenue Act of 1932, a loss sustained by the taxpayer on his individual transactions in stocks and bonds which were non-capital assets may be offset against his share of partnership profits realized during the same period from sales or exchanges of similar non-capital assets.

2. Whether Section 23 (r), if construed to prevent such offsetting, is unconstitutional.

3. Whether the commissions paid by the taxpayer upon purchases of securities for his own account are deductible as a business expense.

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of the statute and regulations involved are printed in the Appendix, *infra,* pp. 9–14.

STATEMENT

The facts as stipulated (R. 12–19) and as found by the Board of Tax Appeals (R. 20–22) may be summarized as follows:

Petitioner, a resident of New York, was a member of the New York Stock Exchange. He was engaged in the business of trading in securities on the floor of the Exchange for the partnership of Hilson & Neuberger, of which he was a member, on behalf of customers of the partnership, and for his individual account (R. 20–21).

During the year 1932, petitioner sustained a net loss of $25,588.93 from his individual trading in securities which were not capital assets as defined in Section 101 of the Revenue Act of 1932. In computing this loss he treated commissions which he paid upon the purchase of securities as part of their cost. The commissions were paid by the taxpayer to the firm of Hilson & Neuberger and were reported by it as income for 1932; they were not separately deducted in the taxpayer's return for that year (R. 21).

Hilson & Neuberger, as a partnership, derived a profit of $142,802.29 during the taxable year from sales of securities which were not capital assets within the meaning of Section 101 of the Revenue Act of 1932. The firm had other income, including commissions received, of $170,830.65 and deductions of $203,981.78, or a net income of $109,651.06 (R. 21). The taxpayer's distributive share of the partnership profits amounted to $44,158.55 (R. 15).

In his income tax return for 1932, petitioner deducted from his net taxable income the loss of $25,588.93 which he had sustained in his individual transactions in non-capital assets. The Commissioner disallowed the deduction and the taxpayer thereupon sought review in the Board of Tax Appeals. Before the Board, the taxpayer claimed that he was entitled to the deduction disallowed; he also claimed, in the alternative, that should the Commissioner's action be sustained, he was entitled to deduct as a business expense the commissions which he had paid on the purchase of securities sold in 1932. The Board held that the taxpayer was not entitled to deduct the loss of $25,588.93 sustained in his transactions in non-capital assets, but that he was entitled to deduct the commissions of $2,133.63 paid on the purchase of securities sold during the taxable year. Both parties appealed to the court below, which held that neither deduction was allowable.

ARGUMENT

1. Petitioner's claim that he is entitled to deduct the loss of $25,588.93 sustained in the purchase and sale of non-capital assets is based on the theory that under Section 23 (r) of the Revenue Act of 1932 non-capital losses sustained by a taxpayer as an individual may be offset against his distributive share of partnership income to the extent that such income is derived by the partnership from non-capital gains. The court below decided this issue against petitioner on the authority of its own earlier decision in *Johnston* v. *Commissioner*, 86 F. (2d) 732, where the holding was that under Section 23 (r), partnership income derived from a non-capital gain

does not retain its peculiar character as a non-capital gain when it is distributed to the members of the partnership and that, therefore, an individual non-capital loss of one of the partners may not be offset against his distributive share of the partnership profits. This Court denied certiorari in the *Johnston* case, 301 U. S. 683.

This aspect of the decision below, which involves merely a narrow question of statutory construction, is not in conflict with any decision of this Court or of any other circuit court of appeals.[1] It presents no question of general importance because Congress, by Section 182 of the Revenue Act of 1938 (c. 289, 52 Stat. 447), has expressly provided that for the year 1938 and subsequent years taxpayers may deduct personal losses on the sale of non-capital assets from partnership gains derived from the sale of similar assets. In view of the enactment of this statute there is even less occasion to review the decision in this case than there was to review the decision in the *Johnston* case, *supra*.

---

[1] There is no conflict, as petitioner asserts, with *United States* v. *Coulby*, 258 Fed. 27 (C. C. A. 6th), affirming, *per curiam*, 251 Fed. 982 (N. D. Ohio). The question there was simply whether, under the income tax law of 1913 (c. 16, 38 Stat. 172), a member of a partnership was required to include in his net income subject to the normal tax such part of his distributive share of the partnership profits as reflected income derived by the partnership from dividends on corporate stock. The decision that the taxpayer was exempt from taxation on this portion of the partnership income was based squarely on the court's interpretation of the specific provisions of the 1913 Act. The decision, therefore, is in no way inconsistent with the decision below, which is based upon the construction of entirely different provisions of an entirely different revenue law.

2. In the court below, petitioner contended that Section 182 of the Revenue Act of 1938, specifically allowing, for the year 1938 and subsequent years, the type of deduction disallowed to the taxpayer for the year 1932, showed Congressional disapproval of the ruling in the *Johnston* case and required the conclusion that Congress intended that the deduction claimed should be allowed under the Revenue Act of 1932. The refusal of the court below to adopt this contention is alleged to be in conflict with the decision of this Court in *Jordan* v. *Roche*, 228 U. S. 436.

In the *Jordan* case, the question was whether Porto Rican bay rum was taxable under the general provisions of an act of 1900. In an earlier case, the Circuit Court of Appeals for the Second Circuit had held the product to be exempt under the 1900 act. Thereupon Congress, in 1909, enacted a statute specifically providing for the taxation of Porto Rican bay rum. The taxpayer in the *Jordan* case urged that this specific provision embodied in the later statute indicated that the product was not taxable under the 1900 act. This Court rejected the contention, stating that the history of the later statute showed that it "was not the declaration of a new policy but a more explicit expression of the purpose of the prior law, made necessary by the judicial construction of that law." (228 U. S. at 446.)

There is nothing inconsistent between the decision in the *Jordan* case and the decision below. The usual inference is that when a statute is amended the purpose is that of change rather than that of declaring its former meaning. In the *Jordan* case this inference was refuted by legislative history clearly indicating that the partic-

ular amendment involved was intended merely as an explicit expression of the purpose of the prior law. There is no comparable legislative history here and petitioner points to no reason why, under the circumstances of the present case, the usual inference should not be drawn.

3. Disallowance of the deduction for the taxpayer's loss on the sale of non-capital assets does not, as petitioner suggests, present an important or doubtful question of constitutional law. The right to take deductions is wholly a matter of statutory privilege which may be granted or withheld in the discretion of Congress. The constitutional issue which petitioner seeks to raise has been decided against him in other cases in which this Court has denied petitions for writs of certiorari. *Johnston* v. *Commissioner, supra; Davis* v. *United States,* 87 F. (2d) 323 (C. C. A. 2d), certiorari denied, 301 U. S. 704; *Klingenstein* v. *United States,* 18 F. Supp. 1015 (C. Cls.), certiorari denied, 302 U. S. 716. Moreover, because of the enactment of Section 182 of the Revenue Act of 1938, the question will not arise for any year subsequent to 1937.

4. The only other reason advanced for issuance of the writ relates to the holding of the court below that the taxpayer was not entitled to a deduction as a business expense of the commissions of $2,133.63 which he paid to the firm of Hilson & Neuberger on the purchase of securities sold by him during 1933. Petitioner alleges that this holding "erroneously interprets" the decision of this Court in *Helvering* v. *Winmill,* 305 U. S. 79; no conflict with that decision or with the decision of any other circuit court of appeals is shown.

In *Helvering* v. *Winmill*, this Court held that commissions paid upon the purchase of securities are not deductible from income but must be added to the cost of the securities. Petitioner urged in the court below that the rule there declared is not applicable to this case because the commissions here were paid by petitioner to his partnership and were reflected in the partnership income, of which petitioner received his distributive share. The attempted distinction has no support in principle or authority. The court below was clearly correct in holding that the interest of the taxpayer in the brokerage firm to which he paid the commissions did not change the character of the commissions as capital expenditures of the taxpayer.

CONCLUSION

The decision of the Circuit Court of Appeals is correct, and is not in conflict with any decision of this Court or of any other circuit court of appeals. The petition for a writ of certiorari should be denied.

Respectfully submitted.

ROBERT H. JACKSON,
Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
SEWALL KEY,
F. E. YOUNGMAN,
Special Assistants to the Attorney General.
RICHARD H. DEMUTH,
Special Attorney.

DECEMBER 1939.

APPENDIX

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) *Expenses.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * * *

(e) *Losses by Individuals.*—Subject to the limitations provided in subsection (r) of this section, in the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

(3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft. No loss shall be allowed as a deduction under this paragraph if at the time of the filing of the return such loss has been claimed as a deduction for estate tax purposes in the estate tax return.

* * * * *

(r) *Limitation on Stock Losses.*—

(1) Losses from sales or exchanges of stocks and bonds (as defined in subsection (t) of this section) which are not capital assets (as defined in section 101) shall be allowed only to the extent of the gains from such sales or exchanges (including gains which may be derived by a taxpayer from the retirement of his own obligations).

(2) Losses disallowed as a deduction by paragraph (1), computed without regard to any losses sustained during the preceding taxable year, shall, to an amount not in excess of the taxpayer's net income for the taxable year, be considered for the purposes of this title as losses sustained in the succeeding taxable year from sales or exchanges of stocks or bonds which are not capital assets.

(3) This subsection shall not apply to a dealer in securities (as to stocks and bonds acquired for resale to customers) in respect of transactions in the ordinary course of his business, nor to a bank or trust company incorporated under the laws of the United States or of any State or Territory, nor to persons carrying on the banking business (where the receipt of deposits constitutes a major part of such business) in respect of transactions in the ordinary course of such banking business.

(s) *Same—Short Sales.*—For the purposes of this title, gains or losses (A) from short sales of stocks and bonds, or (B) attributable to privileges or options to buy or sell such stocks and bonds, or (C) from sales or exchanges of such privileges or options, shall be considered as gains or losses from sales or exchanges of stocks or bonds which are not capital assets.

(t) *Definition of Stocks and Bonds.*—As used in subsections (r) and (s), the term "stocks and bonds" means (1) shares of stock in any corporation, or (2) rights to subscribe for or to receive such shares, or (3) bonds, debentures, notes, or

certificates or other evidences of indebtedness, issued by any corporation (other than a government or political subdivision thereof), with interest coupons or in registered form, or (4) certificates of profit, or of interest in property or accumulations, in any investment trust or similar organization holding or dealing in any of the instruments mentioned or described in this subsection, regardless of whether or not such investment trust or similar organization constitutes a corporation within the meaning of this Act.

SUPPLEMENT F—PARTNERSHIPS

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

SEC. 182. TAX OF PARTNERS.

(a) *General Rule.*—There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year. If the taxable year of a partner is different from that of the partnership, the amount so included shall be based upon the income of the partnership for any taxable year of the partnership ending within his taxable year.

* * * * *

SEC. 183. COMPUTATION OF PARTNERSHIP INCOME.

The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except that the so-called "charitable contribution" deduction provided in section 23 (n) shall not be allowed.

SEC. 184. CREDITS AGAINST NET INCOME.

The partner shall, for the purpose of the normal tax, be allowed as a credit against his net income, in addition to the credits allowed to him under section 25, his proportionate share of such

amounts of dividends and interest specified in section 25 (a) and (b) as are received by the partnership.

SEC. 185. EARNED INCOME.

In the case of the members of a partnership the proper part of each share of the net income which consists of earned income shall be determined under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary and shall be separately shown in the return of the partnership and shall be taxed to the member as provided in this Supplement.

SEC. 186. CAPITAL NET GAINS AND LOSSES.

In the case of the members of a partnership the proper part of each share of the net income which consists, respectively, of ordinary net income, capital net gain, or capital net loss, shall be determined under the rules and regulations to be prescribed by the Commissioner with the approval of the Secretary, and shall be separately shown in the return of the partnership and shall be taxed to the member as provided in this Supplement, but at the rates and in the manner provided in section 101 (a) and (b), relating to capital net gains and losses.

SEC. 187. NET LOSSES.

The benefit of the special deduction for net losses allowed by section 117 shall be allowed to the members of a partnership under regulations prescribed by the Commissioner with the approval of the Secretary.

SEC. 188. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF THE UNITED STATES.

The amount of income, war-profits, and excess-profits taxes imposed by foreign countries or possessions of the United States shall be allowed as a credit against the tax of the member of a partnership to the extent provided in section 131.

SEC. 189. PARTNERSHIP RETURNS.

Every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this title, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

(a) As a part of his short-term capital gains or losses, his distributive share of the net short-term capital gain or loss of the partnership.

(b) As a part of his long-term capital gains or losses, his distributive share of the net long-term capital gain or loss of the partnership.

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b).

Treasury Regulations 77, promulgated under the Revenue Act of 1932:

ART. 121. *Business expenses.*—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except the classes of items which are deductible under the provisions of articles 141–272. The cost of goods purchased for resale, with proper adjustment for opening and closing inventories, is deducted from gross sales in computing gross income. (See article 55.) Among the items included in business expenses are management expenses, commissions, labor, supplies, incidental repairs, operating expenses of automobiles used in the trade or business,

traveling expenses while away from home solely in the pursuit of a trade or business (see article 122), advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business, and rental for the use of business property. A taxpayer is entitled to deduct the necessary expenses paid in carrying on his business from his gross income from whatever source. As to items not deductible, see section 24 and articles 281–284.

ART. 282. *Capital expenditures.*—Amounts paid for increasing the capital value or for making good the depreciation (for which a deduction has been made) of property are not deductible from gross income. (See section 23 (k) and article 201.) Amounts expended for securing a copyright and plates, which remain the property of the person making the payments, are investments of capital. The cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense. The amount expended for architects' services is part of the cost of the building. Commissions paid in purchasing securities are a part of the cost price of such securities. Commissions paid in selling securities, when such commissions are not an ordinary and necessary business expense, are an offset against the selling price. * * *

U. S. GOVERNMENT PRINTING OFFICE: 1939

FILE COPY

Office - Supreme Court, U. S.
FILED
FEB 28 1940
CHARLES ELMORE CROPLEY
CLERK

No. [redacted] 5

In the Supreme Court of the United States

OCTOBER TERM, 1939

HARRY H. NEUBERGER, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR REHEARING OF PETITION FOR CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT

In the Supreme Court of the United States

OCTOBER TERM, 1939

No. 548

HARRY H. NEUBERGER, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR REHEARING OF PETITION FOR CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT

Petitioner filed a petition for rehearing of its petition for certiorari on the ground that there is a case entitled *Central Hanover Bank & Trust Co.* v. *United States,* now pending in the Court of Claims, which involves the same question as that decided in this case. Petitioner requested the Court to defer consideration of the petition for rehearing until the decision of the Court of Claims in the *Central Hanover* case.

In a Supplemental Memorandum in support of the petition for rehearing, petitioner sets forth that

on February 5, 1940, the Court of Claims decided the case of *Craik* v. *United States,* which is alleged to be in conflict with the decision below and to foreshadow a decision in favor of the taxpayer in the *Central Hanover* case. Petitioner urges that the decision in the *Craik* case warrants the grant of certiorari now without waiting for the decision in the *Central Hanover* case.

Neither the petition for rehearing nor the Supplemental Memorandum reveals that the precise question involved in the present case was decided against petitioner's position by the Court of Claims less than a month prior to the decision in the *Craik* case. *Mosbacher* v. *United States,* decided January 8, 1940.[1] The opinion in the *Mosbacher* case was written by Judge Whitaker who also wrote the opinion in the *Craik* case, the decision was unanimous, and the court expressly reaffirmed its decision in *Klingenstein* v. *United States,* 18 F. Supp. 1015, certiorari denied, 302 U. S. 716, a case which is also directly contrary to petitioner's position.

---

[1] The court stated: "In this case plaintiff seeks to offset certain losses which he claims he sustained in trading on the New York Curb Exchange against his profits therefrom. The issue is whether the losses were sustained by him individually or by an alleged partnership or joint venture of which plaintiff was a member. The answer depends on whether or not the association between plaintiff and certain men named Greenstein, Stern, and Schwartz was a partnership or joint venture or whether these men were employees of the plaintiff in the carrying out of the enterprise. If employees, the plaintiff is entitled to the deduction; if partners or associates in a joint venture, he is not. *Joseph Klingenstein* v. *United States*, 85 Ct. Cls. 165, 18 F. Supp. 1015; *Percy H. Johnston* v. *Commissioner*, 86 F. (2d) 732."

Neither the *Klingenstein* nor the *Mosbacher* case was overruled in the *Craik* case; to the contrary, the *Klingenstein* case was specifically distinguished. Under these circumstances, there is no warrant for believing that the *Craik* decision foreshadows a decision favorable to the taxpayer in the *Central Hanover* case.

Respectfully submitted.

FRANCIS BIDDLE,
Solicitor General.

FEBRUARY 1940.

U. S. GOVERNMENT PRINTING OFFICE: 1940

FILE COPY

Office - Supreme Court, U. S.
FILED
OCT 14 1940
CHARLES ELMORE CROPLEY
CLERK

No. 5

In the Supreme Court of the United States

OCTOBER TERM, 1940

HARRY H. NEUBERGER, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

INDEX

	Page
Opinions below	1
Jurisdiction	1
Questions presented	2
Statutes involved	2
Statement	3
Summary of argument	4
Argument:	
I. The Act forbids the claimed deduction	8
1. The claimed deduction must be denied under the general scheme of the Act	10
2. The authorities relied upon by petitioner are not persuasive	25
3. The uniform administrative and judicial construction of Section 23 (e) and (r) supports the Government	34
II. The Act is constitutional as applied	37
Conclusion	38
Appendix	39

CITATIONS

Cases:	
Alabama Power Co. v. *Ickes*, 302 U. S. 464	37
Ardenghi v. *Helvering*, 100 F. (2d) 406	15, 25
Barclay v. *Edwards*, 267 U. S. 442, 450	38
Billings v. *United States*, 232 U. S. 261	38
Botany Mills v. *United States*, 278 U. S. 282	17, 27
Burnet v. *Thompson Oil and G. Co.*, 283 U. S. 301	7, 36
Burns v. *Commissioner*, 12 B. T. A. 1209	23
Cohn v. *United States*, 23 F. Supp. 534	35
Colip v. *Commissioner*, 5 B. T. A. 123	23
Craik v. *United States*, 31 F. Supp. 132	29
Davis v. *United States*, 87 F. (2d) 323, certiorari denied, 301 U. S. 704	4, 35
Denman v. *Slayton*, 282 U. S. 514	37
Forres v. *Commissioner*, 25 B. T. A. 154	24
Ginsberg & Sons v. *Popkin*, 285 U. S. 204	17, 26
Helvering v. *Ind. Life Ins. Co.*, 292 U. S. 371	37
Jennings v. *Commissioner*, 110 F. (2d) 945, No. 231, this Term	35
Johnston v. *Commissioner*, 34 B. T. A. 276, affirmed, 86 F. (2d) 732, certiorari denied, 301 U. S. 683	4, 29, 32, 35

Cases—Continued. Page

Klauber v. *Commissioner*, 34 B. T. A. 998, affirmed, 92 F. (2d) 1007 ... 35
Klingenstein v. *United States*, 18 F. Supp. 1015, certiorari denied, 302 U. S. 716 ... 29, 35
Kurzman v. *Commissioner*, 8 B. T. A. 412 ... 21
Market Co. v. *Hoffman*, 101 U. S. 112 ... 17, 26
Massachusetts v. *Mellon*, 262 U. S. 447 ... 37
Menken v. *Commissioner*, 8 B. T. A. 1062 ... 22
New Colonial Co. v. *Helvering*, 292 U. S. 435 ... 7, 36, 37
Perkins v. *Lukens Steel Co.*, 310 U. S. 113 ... 37
Public National Bank, Ex parte, 278 U. S. 101 ... 17, 26
Sartorius v. *Commissioner*, 35 B. T. A. 1233, dismissed, January 26, 1938, certiorari denied, 301 U. S. 688 ... 35
Shearer v. *Burnet*, 285 U. S. 228 ... 22
Tennessee Electric Power Co. v. *Tennessee Valley Authority*, 306 U. S. 118 ... 37
Tigner v. *Texas*, 310 U. S. 141 ... 38
United States v. *Coulby*, 258 Fed. 27, affirming 251 Fed. 982 ... 33
United States v. *Hudson*, 299 U. S. 442 ... 38
White v. *Commissioner*, 37 B. T. A. 1106 ... 35
Wilson v. *Commissioner*, 17 B. T. A. 976, appeal dismissed, 55 F. (2d) 1086 ... 22
Winmill v. *Commissioner*, 93 F. (2d) 494, reversed, 305 U. S. 79 ... 35
Woolford Realty Co. v. *Rose*, 286 U. S. 319 ... 15, 25

Statutes:

National Industrial Recovery Act, c. 90, 48 Stat. 195, Sec. 218 (d) ... 30, 32
Revenue Act of 1913, c. 16, 38 Stat. 114, Sec. 2 ... 33
Revenue Act of 1916, c. 463, 39 Stat. 756 ... 34
Revenue Act of 1924, c. 234, 43 Stat. 253:
Sec. 1200 (a) ... 23
Sec. 1201 (a) and (b) ... 23
Revenue Act of 1932, c. 209, 47 Stat. 169:
Sec. 22 ... 30
Sec. 23 ... 5, 32, 34
Sec. 25 ... 16, 25
Sec. 101 ... 8, 32
Sec. 117 ... 31
Sec. 131 ... 17
Sec. 143 ... 27
Sec. 181 ... 11
Sec. 182 ... 31
Sec. 183 ... 5, 9
Sec. 184 ... 16, 25, 26
Sec. 185 ... 16, 26
Sec. 186 ... 16, 26, 32
Sec. 187 ... 16, 31

Statutes—Continued.
Revenue Act of 1932—Continued. Page
Sec. 188 ..... 17, 26
Sec. 189 10
Sec. 212 28
Sec. 218 30
Revenue Act of 1934, c. 277, 48 Stat. 680:
Sec. 117 18
Revenue Act of 1936, c. 690, 49 Stat. 1648:
Sec. 117 18
Revenue Act of 1938, c. 289, 52 Stat. 447:
Sec. 182 ..... 18, 19
Sec. 183 ..... 18, 19
Miscellaneous:
G. C. M. 13771, XIII–2 Cum. Bull. 229 (1934), modified, G. C. M. 17255, XV–2 Cum. Bull. 243 (1936) 29
G. C. M. 14012, XIV–1 Cum. Bull. 145 (1935) 29, 34–35
G. C. M. 18120, 1937–1 Cum. Bull. 151 28
G. C. M. 21478, 1939 CCH, Par. 6455 35
H. Rep. No. 708, 72d Cong., 1st Sess 36
H. R. 5755, 73d Cong., 1st Sess., p. 41 31
IT 2892, XIV–1 Cum. Bull. 148 35
OD 593, Cum. Bull. 3, p. 10 22
3 Paul and Mertens, *Law of Federal Income Taxation* (1934), c. 27 31
S. Rep. No. 114, 73d Cong., 1st Sess 30
H. Rep. No. 1860, 75th Cong., 3d Sess., pp. 42–43 18
S. Rep. No. 665, 72d Cong., 1st Sess 36
Treasury Regulations 77, promulgated under the Revenue Act of 1932:
Art. 89 30
Art. 121 .....
Art. 282 .....

In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 5

HARRY H. NEUBERGER, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUI '

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 20–23) is reported at 37 B. T. A. 223. The opinion of the Circuit Court of Appeals (R. 46–47) is reported in 104 F. (2d) 649.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on June 29, 1939 (R. 53). The time within which to file a petition for a writ of certiorari was extended for a period of 60 days from

September 26, 1939, by an order on that date signed by a Justice of this Court (R. 54). The petition for a writ of certiorari was filed on November 21, 1939, and granted on May 27, 1940, limited to the second and third questions presented (R. 55). The jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

The second and third questions, as stated in the petition for a writ of certiorari (Pet. 2), are:

1. Whether, under Section 23 (r) of the Revenue Act of 1932, petitioner, engaged in the business of trading in securities, may offset losses on the sale of noncapital securities owned by him as an individual, against profits from the sale of noncapital securities owned by him and another as partners.

2. Whether, if construed to deny such offset, Section 23 (r) of the Revenue Act of 1932 is constitutional, as applied in this case, where petitioner's business activities in trading for his own account and for the account of the partnership against whose profits he seeks to offset his losses were interwoven in one continuous course of business.

STATUTES INVOLVED

The relevant provisions of the statutes involved are set forth in the Appendix, *infra*, pp. 39-45.

STATEMENT

The pertinent facts, as stipulated (R. 12–19) and as found by the Board of Tax Appeals (R. 20–22), may be summarized as follows:

Petitioner, a resident of New York, was a member of the New York Stock Exchange. He was engaged in the business of trading in securities on the floor of the Exchange for the partnership of Hilson & Neuberger, of which he was a member, executing orders on behalf of customers of the partnership and for his individual account (R. 20–21).

During the year 1932, petitioner sustained a net loss of $25,588.93, on his individual trading, from sales or exchanges of stocks and bonds which were not capital assets as defined in Section 101 of the Revenue Act of 1932 (R. 12, 14).

During the same year Hilson & Neuberger, as a partnership, derived a profit of $142,802.29 from sales of stocks and other securities which were not capital assets as defined in Section 101 of the Revenue Act of 1932. The firm had other income of $170,830.65, and deductions of $203,981.78, or a net income of $109,651.06 (R. 13, 21). Petitioner's distributive share of the partnership profits amounted to $44,158.55 (R. 13, 15, 21).

Petitioner in his 1932 tax return deducted from his taxable income the loss of $25,588.93 [1] sustained

[1] This item is shown on the return as $27,096.88 (R. 15), but was adjusted by agreement of the parties to $25,588.93 (R. 12).

in his individual transactions in noncapital assets (R. 15, 17–19). The Commissioner disallowed the deduction and determined a deficiency (R. 8–10, 20).

The Board of Tax Appeals, on review, upheld the action of the Commissioner disallowing the deduction for the loss of $25,588.93 sustained by petitioner in his individual transactions in noncapital assets (R. 22–23).

On appeal, the Circuit Court of Appeals for the Second Circuit (on the authority of its earlier decisions in *Johnston* v. *Commissioner,* 86 F. (2d) 732, certiorari denied, 301 U. S. 683, and *Davis* v. *United States,* 87 F. (2d) 323, certiorari denied, 301 U. S. 704) affirmed the decision of the Board on the ground that, under Section 23 (r) of the Revenue Act of 1932, the loss sustained by petitioner on his individual trading in noncapital assets could not be offset against his share of the profits realized by a partnership from its trading in similar noncapital assets, and that Section 23 (r), as thus construed, was constitutional (R. 47).

This Court granted certiorari limited to the issues concerning the construction and constitutionality of Section 23 (r) (R. 55).

SUMMARY OF ARGUMENT

Section 23 (e) and (r) of the Revenue Act of 1932 provides that, in the case of an individual, a deduction from gross income will be allowed for

losses sustained from sales or exchanges of non-capital stocks and bonds (as defined in Sections 23 (r) and 101) only to the extent of the gains realized from similar sales or exchanges. A partnership, by Section 183, is allowed the same deductions from its gross income as in the case of an individual. Both the partnership and the petitioner, therefore, have been allowed the deduction authorized by Section 23 (e) and (r).

Petitioner here claims the right to another deduction, in addition to that specifically allowed by Sections 23 (e) and (r) and 183, from the gross income of the partnership. His apparent position requires that items of partnership *gross* income be used in the computation on his individual return.

The general scheme of the 1932 Act for computing and taxing partnership net income, following the pattern established in 1918, negatives the claim to use such a method of computation as that advocated by petitioner. Under that scheme, the partnership group is a net-income computing and reporting unit and only the end result of the computation of net income finds its place in the return of the individual partners. The position taken by petitioner ignores the fact that the partnership is the net-income computing unit while each individual partner is the tax-paying unit. Gross income received by the partnership can be offset only by deductions for losses sustained by the partnership. There is abundant evidence illustrating the fact

that the general scheme of the Act is as explained. Sections 184, 185, 186, and 188 concededly would all become mere surplusage under the contention advanced by petitioner. The "general rule" expressed in Section 182 (a), that his distributable share of the partnership "net income" shall be included in computing the net income of the individual partner, is inconsistent with the contention of petitioner that items of partnership gross income may be included in the computation on his individual return. The Act of 1938, moreover, carefully preserves this general scheme by *excluding* from the computation of partnership net income the items specifically authorized to be offset against like items from individual transactions. Congress specifically recognized that in making provision for such an offset it was changing the existing law under the Acts of 1934 and 1936 which are similar, in this respect, to the Act of 1932.

None of the authorities cited by petitioner are persuasive. All instances of administrative construction, with one possible exception, are concerned with credits against tax and credits against net income. Such credits do not become applicable until *after* the amount of net income has been determined. Accordingly, they have no bearing upon the method of computing net income under the Act and furnish no support for petitioner's claim to take an additional deduction from gross income realized by the partnership. The one pos-

sible exception was made to meet a special situation. The grants of specific statutory authority to take credits, likewise relied upon by petitioner, clearly support the Government because under petitioner's view they would be mere surplusage.

The issue before this Court arises only under Sections 23 (e) and (r) of the Revenue Act of 1932. The administrative and judicial construction of these provisions on the precise issue raised in this case has been uniform and undeviating. It is submitted that, in these circumstances, such construction should be determinative. And this conclusion is fortified by the established rule, repeatedly recognized by this Court, that a claimed deduction from gross income must be denied in the absence of clear and specific statutory authorization. *New Colonial Co.* v. *Helvering,* 292 U. S. 435, 440; *Burnet* v. *Thompson Oil and G. Co.,* 283 U. S. 301.

Section 23 (r) as applied is clearly constitutional. The claim made by petitioner is a claim to a deduction from gross income. Such a deduction is authorized only as an act of legislative grace. It follows that conditions and limitations upon the method of computing the deduction are within the complete discretion of Congress. Petitioner has no standing to protest that Congress should have been even more generous. Section 23 (r), in any event, is valid. Its legislative history demonstrates that reasonable men might per-

ceive that in fact different consequences result from speculation in securities than result from other types of speculation. Congress may act on these differences.

ARGUMENT

I

THE ACT FORBIDS THE CLAIMED DEDUCTION

The first question presented upon this review raises an issue concerning the proper construction of subsections (e) and (r) of Section 23 of the Revenue Act of 1932. Subsection (e) states the general rule that in computing net income there shall be allowed as deductions from gross income, in the case of an individual, subject to the limitations in subsection (r), losses sustained during the taxable year (not compensated for by insurance or otherwise) if incurred in trade or business or in any transaction entered into for profit. The deductions thus authorized are then limited by the provision in subsection (r) that losses from sales or exchanges of stocks and bonds which are not capital assets (as defined in Section 101) shall be allowed only to the extent of the gains from such sales or exchanges (including gains which may be derived by a taxpayer from the retirement of his own obligations).

The facts upon which this issue arises may be described in this wise: The partnership of which petitioner was a member derived a net profit (in excess of all gains offset by losses, if any) from

sales of noncapital stocks and bonds (as described in Sections 23 (r) and 101) of over $140,000. His distributive share of the total net profit of the firm (total gross income less total deductions allowed) amounted to $44,158.55. Petitioner as an individual realized a net loss (in excess of all losses offset by gains) from individual sales and exchanges of similar securities in the amount of $25,588.93. This proceeding comes before this Court to test his asserted right, under subsections (e) and (r), to deduct the net loss of $25,588.93 sustained in his individual transactions from the net profit of $44,158.55 attributable to firm activities and distributable to him by virtue of his firm membership.

The precise nature of the claim advanced by petitioner should be clearly understood at the outset. Subsections (e) and (r) allow him to deduct from his gross income all losses sustained from his individual transactions in noncapital securities to the extent of the gains from such transactions; petitioner took full advantage of the deduction thus allowed. Subsections (e) and (r), together with Section 183,[2] also allow the partnership in computing its net income to deduct from its gross income all the losses sustained, to the extent of the gains

[2] Section 183 reads: "The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except that the so-called 'charitable contribution' deduction provided in section 23 (n) shall not be allowed."

realized, from its transactions in noncapital securities; the partnership presumably took full advantage of this deduction. It is evident, therefore, that the partnership and the petitioner have been treated as separate individuals for the purpose of computing net income, and that each has been allowed the full deduction from gross income which subsections (e) and (r) authorize in the case of an individual. The petitioner, not satisfied with the deduction from gross income specifically allowed (by Sections 23 (e), 23 (r) and 183) in computing the net income of a partnership, now asserts the right to an additional deduction from the partnership gross income from its noncapital security transactions which is, allegedly, the source of the net income distributable to him.

The Government's position is that the scheme of the Act for computing and taxing partnership net income negatives the existence of a right to such a deduction and that, in any event, under settled rules of construction, a claim for a deduction not specifically authorized by the Act must be denied.

1. THE CLAIMED DEDUCTION MUST BE DENIED UNDER THE GENERAL SCHEME OF THE ACT

The general scheme of the Revenue Act of 1932 for computing and taxing partnership net income follows the pattern first introduced in the 1918 Act and repeated in all subsequent Acts. Every partnership, by Section 189, is required to make a return for each taxable year stating specifically

the items of its gross income and the deductions from gross income allowed by the Act. The net income of the partnership, thus to be reported, is required by Section 183 to be computed in the same manner and on the same basis as in the case of an individual (except for the so-called charitable contribution). Among the deductions entering into the computation of the partnership net income is the deduction allowed, in the case of an individual, by subsections (e) and (r) of Section 23. See Section 183. The net income of the partnership is not taxed directly to the firm as such. Individuals carrying on business in partnership are by Section 181 made liable for income tax only in their individual capacity. In order to subject the partnership net income to taxation, therefore, Section 182 lays down the general rule that there shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year.

It is evident that the partnership, under this general scheme, acts as a net-income computing and reporting unit. No other method of computing the net income attributable to the activities of the firm is mentioned or described in the Act. The net income thus computed is then, by Section 182, required to be included in computing the net income of the individual members of the firm. The deduction here claimed by petitioner, quite evidently, would never arise under the method and manner of

computation specifically described. Accordingly, in order to support his claim, petitioner must assert the right to recompute the items of gross income and the allowable deductions from gross income. Petitioner (Br. 5, 9, 14, 17, 23) would find authority for such a recomputation in a general principle, assertedly pervading all the revenue acts from 1913 to 1932, inclusive, whereby "items of partnership income retain the same character on individual partners' returns as they had on the partnership return."

This statement of the so-called general principle is conveniently, if not designedly, vague. The merest glance at Section 23 (e) and (r) discloses that the deduction there allowed may be taken, in the case of an individual, only from the gross income (total gain) realized from sales or exchanges of non-capital securities. There is no authority anywhere in the Act for taking this deduction, for losses sustained in noncapital security sales, from net income. Accordingly, in order to come within Section 23 (e) and (r), a partner asserting a claim like petitioner's must ascertain, as a distinct item, the gross income (total gain) derived from the sales of noncapital securities by his firm. Only in that event can the individual partner, in computing his net income, find the essential basis for the deduction allowed by Section 23 (e) and (r). There are two methods, conceivably, by which the individual partner might ascertain the gross income

(total gain) derived from the sales of noncapital securities by his firm. The most obvious method is to report on his individual return, as his gross income, his share of the item reported on the firm return as its gross income (total gain) from the sale of noncapital securities. But, if one item of gross income on the partnership return be reported (according to share) as an item of gross income on the individual return, then clearly all other gross income items should be so reported. Likewise, all items of deductions from gross income (for expenses, interest, taxes, and losses) should be so reported. This method would result in an amalgamation of (a share of) the gross income and deductions of the partnership group with the gross income and deductions of each individual partner.

The other method of ascertaining the basis for the deduction allowed by Section 23 (e) and (r)—that is, the gross income (total gain) derived from sales or exchanges of noncapital securities—would start with the figure reported as its *net income* on the return of the partnership. Each partner would then trace (his distributive share of) the net income to its source so as to ascertain what amount of the net income, if any, was attributable to the gross income (total gain) derived from the sales of noncapital securities. It appears to be beyond dispute that the net income must be broken down in such a manner. For, obviously, there is no authority allowing a deduction from that net in-

266302—40——2

come as such. And, be it noted, this is true even though the firm net income is reported on the return of the individual partner (according to his share) as his gross income. Section 23 (e) and (r) allows a deduction only from the gross income (total gain) *derived from sales of noncapital assets.* But, in tracing the firm net income to its source, under this method, it is not enough to ascertain merely the amount of gross income (total gain) from sales of noncapital securities reported on the return of the partnership group. Nor is it enough to ascertain merely the amount of net gain (total gain less total losses allowed as deductions) from sales of noncapital securities reported on the firm return. Items of total gain or net gain, from such transactions, might be reported on the return of the partnership and yet all of its *net income* might be derived from other sources. The reason for this is that many items, other than losses from sales of noncapital securities, are allowed as deductions from gross income from all sources. Thus office rent, salaries, taxes, and bad debts are allowed as deductions from the total gross income received by the partnership group, without regard to source. In the return of the petitioner, for example, deductions of over $200,000 were allowed from the total gross income from all sources (R. 13, 21). Partnership *net income* is thus the result of a computation, subtracting total allowable deductions from total gross income. In order to trace partnership *net income* into particular items of gross income,

obviously, the total allowable deductions must be allocated among the total gross-income items. And, it follows, in order to trace firm *net income* into *gains from sales of noncapital securities,* a similar allocation of deductions would have to be made in the case at bar. No such allocation was attempted, or even suggested, by petitioner. It would appear, therefore, that petitioner has in mind and is relying upon the method of ascertaining the gains from noncapital-security transactions first described.[8]

---

[8] The converse of the situation here presented serves in dramatic fashion to illustrate our point. If the partnership has excess noncapital security *losses*, and the individual member excess similar *gains*, the losses, if they would be offset, would have to be used directly in the return of the individual member. Such losses could not be the source of positive net income; and "certainly the average man suffering a net loss from the operations of his business would learn with surprise that, within the meaning of the Congress, the amount of his net loss was also the amount of his net income." *Woolford Realty Co.* v. *Rose*, 286 U. S. 319, 327. Compare *Ardenghi* v. *Helvering*, 100 F. (2d) 406, 407 (C. C. A. 2d).

If, however, petitioner should claim to be relying upon the second method, the necessary facts upon which to base the deduction authorized by Section 23 (e) and (r) do not appear in the record. There is no reason to assume that the deductions of $203,981.78 should be allocated, in whole or in part, to the income from sources other than the sales of noncapital securities. And, even if an arbitrary allocation were made in proportion to the items of gross income, petitioner's distributive share of the firm net income, attributable to security transactions, would be only approximately $20,000.

In any event, we submit, such a method of computation is contrary to the scheme of the Act. It would require an individual partner to go behind the return of the partner-

There remains for consideration the question whether a general principle, contemplating such a method of computation, can be reconciled with the scheme of the Act.

Any such principle, if it existed, would render meaningless the provisions embodied in Sections 184, 185, 186, and 187. Section 184 states that a partner, for the purpose of the normal tax, shall be allowed as a credit against his net income, in addition to the credits allowed to him under Section 25, his proportionate share of such amounts of dividends and interest specified in Section 25 (a) and (b) as are received by the partnership. Such dividends and interest, if there existed any such principle as advocated by petitioner, would have been treated as received by each partner individually and would have been covered by Section 25 (a) and (b). Similarly, Section 185 provides for an "earned income" credit; Section 186 has special provisions for taxing "capital net gains

---

ship and to make an allocation of deduction items according to information not reported on the firm return. The partnership returns used for the past 20 years would, under such a method, cease to be "information" returns in any real sense either to the Commissioner or to the taxpayer. None of the returns required by the Commissioner, since the Act of 1918, has ever provided for such an allocation of deduction items as would be required under this method. This continuous, undeviating construction of the Act, with reference to the information to be required on a partnership return, demonstrates persuasively that this method of computation, requiring other information, is clearly erroneous and contrary to the scheme of the Act.

and losses" included in the partnership net income; and Section 188 allows as a credit against the tax of the member, to the extent provided in Section 131, the amount of income, war profits, and excess-profits taxes imposed on the partnership by foreign countries or possessions of the United States. All these provisions, if petitioner is right, become mere surplusage. *Market Co.* v. *Hoffman,* 101 U. S. 112, 115; *Ex parte Public National Bank,* 278 U. S. 101, 104; *Ginsberg & Sons* v. *Popkin,* 285 U. S. 204, 208. See *Botany Mills* v. *United States,* 278 U. S. 282, 289.

Such a principle, moreover, is directly contrary to the "general rule," expressed in Section 182 (a), that the net income of the partnership distributable to a partner shall be included in computing his individual net income. There is no intimation in Section 182 (a) that items of partnership gross income and allowable deductions for losses sustained shall be included in the return or in the computation of the net income of the individual member of a partnership. On the contrary, the inclusion of such items cannot be reconciled with the sole direction to include in the computation the net income distributable to the member. Since Section 182 (a) is specifically designated as the "general rule," it follows that the inconsistent general principle relied upon by petitioner arises, if at all, independently of any intention expressed by Congress.

Furthermore, the changes made by Congress in enacting the Revenue Act of 1938 are persuasive evidence that the scheme of computation advocated by petitioner was never authorized under the 1932 Act. Section 182 of the 1938 Act provides specifically that, in computing the net income of each partner, he shall include as part of his short-term capital gains or losses his distributive share of the net short-term gain or loss of the partnership. And, it should be noted, Section 183 carefully *excludes* such gains or losses from the computation of the net income of the partnership. These specific provisions enabling short-term capital net losses or gains of the partnership to be offset by like individual net gains or losses were recognized by Congress as a departure from the principle adopted in the Revenue Acts of 1934 and 1936. See Report of the Ways and Means Committee, H. Rep. No. 1860, 75th Cong., 3d Sess., pp. 42–43. In those previous Acts, as the petitioner concedes (Br. 33), the deduction for partnership security losses was allowed only to the partnership as a net income computing unit and was not allowed to the individual partners. The Committee Report notes the change made by the 1938 Act.

Yet the occasion for such an offset was the same under the 1934 and 1936 Acts as under the 1932 Act here involved. All assets were treated under the Acts of 1934 and 1936 (Section 117) as capital assets regardless of the time held and the recognized capital gain or loss was taken into account in com-

puting net income to the extent of a percentage of such gain or loss dependent upon the length of the period during which the asset sold was held. Each Act had a further provision, in Section 117 (d), that losses from sales or exchanges of capital assets should be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. In the event an individual during the years 1934 to 1937 sustained losses from sales of securities greatly in excess of his gains from sales of securities or other assets, even as did the petitioner in the case at bar, his advantage would have been served by asserting the right to offset his individual losses against the gains realized by his partnership from like sales to the extent of his share of such gains. And, if any such general principle as that for which petitioner contends were valid, the right to make such an offset would be clear in the absence of a specific provision forbidding the offset. But the 1934 and 1936 Acts may be searched in vain for any such provision.

Quite to the contrary, a specific provision in Section 182 of the 1938 Act was required to accomplish the result desired by petitioner. And that specific change was accompanied by a corresponding change in the computation of the net income of the partnership; the items which Section 182 authorized to be offset were excluded by Section 183 from the computation of firm net income. The reason that this was done completely refutes the argument advanced by petitioner.

And this reason was concisely explained in the Report of the Ways and Means Committee on the 1938 Act (at p. 42):

> Partnerships are not treated by the revenue act as taxable entities and hence, as such, pay no tax to the Federal Government. *Yet they are regarded as business and accounting units and as such are required to compute their net income in the first instance as individuals, distinct from the natural persons composing them,* and to file returns in the nature of information returns showing the partnership net income. *After the partnership net income has been thus computed, the law requires the individual partners to include* their proper portions of *such net income,* whether or not actually distributed to them by the partnership, *in their own returns in computing their net incomes* as individuals for tax purposes. [Italics supplied.]

This, in short, is our position. The general scheme of the 1932 Act regards a partnership as an accounting unit for the purpose of computing its net income in the same manner as any other individual and requires the net income thus computed to be included in computing the net income reported by the individual members of the firm. Hence, any deductions allowed, in the case of an individual, for losses sustained, may be offset by an individual partner against his individual gross income and may be offset by a partnership against its firm gross income. But, in the absence of a

specific authorization, as in the 1938 Act, losses, allowable as deductions, and sustained by a member of a partnership, may not be offset against the gross income of the firm.

The Act of 1938 carefully refrains from modifying this general scheme whereby items entering into the net income computation on the return of the partnership lose their identity and the net income is reported by the individual members as thus computed. The net income computed on the return of the firm under the 1938 Act is still reported by the individual partners as thus computed; the items of capital gain or loss from firm transactions which may be offset against like items from individual member's transactions are expressly excluded from the computation of net income on the return of the firm. Quite evidently, therefore, the argument that the 1938 Act was intended to be declaratory of the proper construction of the Act of 1932 has no validity. The 1932 Act, by Sections 22, 23 (e) and (r), and 183, expressly provides that losses and gains from sales of noncapital stocks and bonds shall enter into the computation of the net income of the partnership on its return. Accordingly, under the general scheme, still followed in the 1938 Act, such items lose their identity and the net income computed by the firm is reported, as thus computed, by its individual members. The deduction here sought by petitioner requires a method of computation directly counter to this general scheme.

Other instances where the method of computation urged by petitioner has been rejected may be mentioned. Thus, a partner in his individual return may not deduct from gross income sums expended by himself where such sums are ordinary and necessary business expenses of his firm. *Wilson* v. *Commissioner,* 17 B. T. A. 976, appeal dismissed, 55 F. (2d) 1086 (C. C. A. 10th); OD 593, Cum. Bull. 3, p. 130. Similarly, a partner may not take as a deduction from the gross income reported in his return his proportionate share of a bad debt owing to the firm. *Menken* v. *Commissioner,* 8 B. T. A. 1062. These are simple, and obvious, illustrations of the general rule that items entering into the computation of net income on the return of a partnership cannot be used in computing the net income of the individual partners.

One of the clearest examples of the general scheme under which a partnership is utilized as the net-income computing unit is shown by the decision of this Court in *Shearer* v. *Burnet,* 285 U. S. 228. The taxpayers there, who were on a calendar year cash basis, were members of a law partnership which kept its books on the basis of a fiscal year ending April 30th. The partners in their individual returns for the year 1924 included, as was required by Section 218 (a), their respective shares of the partnership profits for the partnership fiscal year ending in 1924. They thus returned, as 1924 net income, partnership profits earned by the partnership during eight

months of the preceding year. In the Revenue Act of 1924, by Section 1200 (a), Congress authorized an allowance to taxpayers returning income for the calendar year 1923 of a credit or refund of 25 percent of the amount shown as the tax on each return. Section 1201 (a) and (b) authorized a similar allowance to taxpayers returning income for a fiscal year beginning or ending in 1923, but only with respect to the tax on so much of the income returned as was attributable to income earned in the calendar year 1923. The taxpayers urged that the items of income received by the partnership and distributed to the partners should be treated as if received by the individual partners directly from the source instead of derivatively through the firm. By making such an argument, which is similar to the one here advanced by petitioner, the taxpayers claimed to come within the alleged intent of the statute to allow the 25 percent refund of tax upon any and all income attributable to the year 1923. This Court (285 U. S. at 232) refused to recognize any such principle which would ignore the firm as a net-income computing unit distinct from its members. See also *Colip* v. *Commissioner,* 5 B. T. A. 123; *Kurzman* v. *Commissioner,* 8 B. T. A. 412.

Yet another illustration is furnished by the case of *Burns* v. *Commissioner,* 12 B. T. A. 1209. The Board there held that a partner reporting on the cash basis was entitled to deduct his share of accrued foreign taxes imposed on his partnership,

reporting on an accrual basis. Decision was rested upon the principle that a partnership is the unit for computing the net income derived from firm transactions. Accord: *Forres* v. *Commissioner*, 25 B. T. A. 154.

The petitioner (Br. 23–24n.) dismisses these cases by simply asserting that they are immaterial and do not question the alleged "principle preserving the identity of partnership income in partners' hands." But, as we have demonstrated (*supra*, pp. 12–14), this so-called principle does not aid petitioner unless it permits items of gross income and deductions from gross income used in the computation on the return filed by the partnership to be used again in the computation of net income on the individual members' returns. These cases show in a persuasive fashion that such a computation is opposed to the general scheme of the Act.

Finally, it is to be observed, the converse of the situation presented in this case illustrates the untenable character of the position taken by petitioner. Suppose, for example, that a partnership realizes noncapital security gains of $1,000, and sustains noncapital security losses of $5,000; and that an individual member realizes noncapital security gains of $10,000 and sustains similar losses of $2,000. If petitioner's argument be sound, the partnership excess noncapital loss of $4,000 (disallowed to the partnership as such) should be offset against the individual excess gains of $8,000.

But, we submit, there is no authority whatever in the Act permitting losses *disallowed* as deductions to the firm to be offset against the net income of the individual partners.[4] The terminology of Section 182 (a), that only his distributive share of the *net income* of the partnership shall be included in the return of the individual partner, completely refutes the argument. Compare *Woolford Realty Co.* v. *Rose,* 286 U. S. 319, 327; *Ardenghi* v. *Helvering,* 100 F. (2d) 406, 407 (C. C. A. 2d).

2. THE AUTHORITIES RELIED UPON BY PETITIONER ARE NOT PERSUASIVE

In support of his position petitioner (Br. 17–18) relies upon specific authorizations in the revenue acts allowing an individual partner in the computation of his tax to take certain credits against tax and against the net income earned by his partnership and distributable to him. But none of these credits enter into the computation of net income on the return of the partnership. Thus, Section 184 provides merely that the partner shall, for the purpose of the normal tax, be allowed as a *credit against his net income* (in addition to credits allowed to him under Section 25) his proportionate share of such amounts of dividends and interest specified in Section 25 (a) and (b) as are received by the partnership. There is nothing in such a provision which militates against our position that

[4] Section 187, permitting the offsetting of "net losses," refers only to the excess losses *allowed* to the partnership. See Section 117.

the net income earned directly by the individual partners and the net income earned by the partnership group shall be computed separately and that items entering into the computation of net income on the return of the partnership shall not be used again in computing the net income of the individual partners. After the net income has been thus computed, and only then, credits against such net income become relevant for the purpose of determining the amount of the tax against the individual partners. The basic fallacy in the position taken by petitioner is that it ignores the fact that the partnership group is the net-income-computing unit while each individual partner is the tax-paying unit. The provisions in Sections 185, 186, and 188 likewise furnish no aid to petitioner for the same reason. Each of these provisions assumes that, prior to its application, the amount of net income has been computed; clearly, therefore, none of them changed the method of computing partnership net income. The computation still is made in the manner for which the Government here contends.

It may be noted, in addition, that the position advocated by petitioner would, as we have demonstrated (*supra*, pp. 16-17), render the provisions of Sections 184, 185, 186 and 188 mere surplusage. Far from aiding petitioner, therefore, his authorities bolster our case. *Market Co.* v. *Hoffman*, 101 U. S. 112, 115; *Ex parte Public National Bank*, 278 U. S. 101, 104; *Ginsberg & Sons* v. *Popkin*, 285

U. S. 204, 208. See *Botany Mills* v. *United States*, 278 U. S. 282, 289.

Petitioner (Br. 18–22) has also found three instances in which the Treasury Department, without express statutory authorization, has allowed credits and exemptions to individual partners by reason of the character of the gross income received by the partnership. An examination of this administrative practice discloses that, here too, the scheme of the Act for computing partnership net income was not intended to be modified. The statutory provisions governing the credit for taxes withheld at the source (Pet. Br. 20–22) may be taken as an example. Section 143 (a) of the Revenue Act of 1932 provides for withholding at the source a tax of 2% on bond interest paid to individuals and to partnerships. The income upon which tax is withheld at the source shall be included in the return of the recipient of such income, under Section 143 (d), "but any amount of tax so withheld shall be *credited against the amount of income tax* as computed in such return." (Italics supplied.) A partnership is not a *taxpaying* unit and, accordingly, does not compute a *tax* in its return. The credit against the *tax* could not possibly be of use to a partnership. It follows that, unless a tax on the bond interest shall be collected twice, the credit provided in Section 143 (d) must be given to the individual partners who pay the tax on the net income computed in the return of the partnership. As an administrative expedient, therefore, in order to carry

out the intent of Congress not to impose a double tax in this instance, the General Counsel of the Treasury ruled that, under the similar provisions of the 1934 Act, a credit against his tax should be allowed to each partner. G. C. M. 18120, 1937–1, Cum. Bull. 151. Quite evidently, however, such a credit has no bearing upon the manner of computing partnership net income. And the credit, moreover, is given only to the individuals and not to the firm. Clearly, the deduction here sought by petitioner, which requires a radical change in the manner of computing partnership net income, and which is in addition to a deduction specifically given to the partnership group, should not be granted in reliance upon the supposed analogy of such an administrative practice.

The other instances cited by petitioner are no more persuasive. Section 212 of the 1932 Act provides that gross income in the case of a nonresident alien individual includes only the gross income from sources within the United States. The General Counsel for the Treasury ruled that a member of a partnership carrying on business in the United States and in a foreign country, who was occupied solely with the business of the firm in the foreign country, and who received a so-called salary of definite amount chargeable first against the profits of the foreign office, should be treated as the recipient of income from sources without the United States to the extent the income of the

foreign office was available to make the distribution. G. C. M. 13771, XIII–2 Cum. Bull. 229 (1934), modified, G. C. M. 17255, XV–2 Cum. Bull. 243 (1936). Since the so-called salary was regarded as a distribution of partnership profits, the ruling that such profits should be regarded as derived from sources without the United States is not entirely consistent with the general scheme of the Act for computing and taxing partnership net income. It may be that Section 212 was given an extended application upon the supposed analogy of the credit provisions. Accord: *Craik* v. *United States,* 31 F. Supp. 132 (C. Cls.).[5] The rulings of the General Counsel contain no discussion of this issue and are concerned primarily with the question whether or not the distribution should be regarded as salary for personal services performed in a foreign country or as partnership profits. In any event, we submit, there was no intention to upset the entire scheme of computing net income of a partnership. The Treasury has consistently ruled, on the precise issue now before this Court, that a deduction such as petitioner claims, must be denied. G. C. M. 14012, XIV–1 Cum. Bull. 145 (1935). That ruling is still in force. And, since

[5] The Court of Claims, in the *Craik* case, limited its holding to the narrow issue before it. It did not disapprove of its own prior decision in *Klingenstein* v. *United States*, 18 F. Supp. 1015, or of the decision of the Second Circuit in *Johnston* v. *Commissioner*, 86 F. (2d) 732, both of which support our position on the precise issue in the case at hand.

it covers this very case, it should be given more weight than the ruling cited by petitioner.

The third instance relates to the treatment of interest on Government bonds. Interest on a principal amount in excess of $5,000 must be included in gross income. Section 22 (b) (4) of the 1932 Act. Article 89, Regulations 77 (Act of 1932) provides that each member of a partnership, and each beneficiary to whom the income of a trust is taxable, is entitled to exemption as if he owned directly a proportionate part of the bonds held by the partnership and held in trust, respectively. Plainly these provisions are based on the theory that the exemption should follow the *tax,* as indeed it must, in order to have any vitality. They are not intended to modify the method of computing net income, obviously, for they apply equally to a trust and to a partnership.

We submit that these instances of administrative practice do not support the position urged by petitioner.

The enactment of Section 218 (d) of the National Industrial Recovery Act sheds no clearer light on the issue raised in this case. The Report of the Senate Finance Committee (S. Rep. No. 114, 73d Cong., 1st Sess., p. 7), cited by petitioner (Br. 27), states that "under existing law the individual members of a partnership are entitled to reduce their individual net incomes by their distributive shares of a *net loss* incurred by the partnership. Your committee amendment denies this deduction to the

extent that the *net loss* is attributable to a loss from the sale or other disposition of stocks and bonds." [Italics supplied.] The term "net loss" as used in the revenue acts is a technical term and is specifically defined in Section 117 (a) of the 1932 Act. See 3 Paul and Mertens, *Law of Federal Income Taxation* (1934), § 27.01 *et seq.*, c. 27. The reference in the Committee Report to a deduction from individual income by the use of a partnership "net loss" may be a reference to Section 187 which specifically allows such a deduction. Section 187 has no bearing upon the issue before this Court.[6]

The petitioner is not aided even though the Report be thought to refer to some other section. Section 218 (d), as reported to the Senate (H. R. 5755, 73d Cong., 1st Sess., p. 41), reads:

> Effective as of January 1, 1933, section 182 (a) of the Revenue Act of 1932 is amended by inserting at the end thereof a new sentence as follows: "No deduction from gross income shall be allowed to a partner on account of any excess of the deductions allowed the partnership under this title over

[6] Section 187 of the Revenue Act of 1932 was specifically repealed by Section 218 (a) of the National Industrial Recovery Act. Despite the repeal, however, the purpose of Congress would not have been fully carried out without the enactment of Section 218 (d) of the National Industrial Recovery Act. Otherwise net losses under the 1928 Act would have been carried over to 1933. Section 117 (b) of the Revenue Act of 1928 allowed a carry over to the *third* year after the net loss, so that the mere repeal of Section 187 of the Revenue Act of 1932 would not have prevented a carry over of a 1931 net loss to 1933.

> the gross income of the partnership to the extent that such excess is attributable to loss from the sale or other disposition of stocks and bonds as defined in section 23 (t)."

Losses from the sale of stocks and bonds (as defined in section 23 (t)) might be either *capital* losses (Section 101) or *noncapital* losses (Sections 23 (r) and 101). Section 186 of the 1932 Act specifically allows *capital* gains or losses of a partnership to be offset against *capital* losses or gains of the individual partners. The Committee Report, cited by petitioner (Br. 27), had reference to the legislation in the form which *deprived* individual partners of a deduction on account of partnership *capital* losses. The Committee was therefore correct in stating that such legislation changed existing law. But it changed the existing law affecting *capital* losses. The final form of the legislation was limited to noncapital losses. The net result was a positive statutory distinction between the method of treating the two types of losses. *Capital* losses or gains of a partnership could be offset against individual *capital* gains or losses; *noncapital* gains or losses could not be so offset.

In our view Section 218 (d) of the National Industrial Recovery Act was "but a clarification of existing law." *Johnston* v. *Commissioner,* 86 F. (2d) 732, 734. At any rate it is clear that "any loss *disallowed* to a partnership as a deduction by Section 23 (r)" could, under no circumstances, affect the individual partners' tax for the year 1932.

Such a result was precluded by virtue of Section 23 (r) (2), which provides that losses disallowed by Section 23 (r) (1) should be considered as losses sustained in the *succeeding taxable year*. It is clear that neither the group nor the individual partners could receive any benefit from such losses in the year 1932. The result of selecting January 1, 1933, as the effective date of Section 218 (d), moreover, was to prevent the individual partners from ever realizing any benefits under Section 23 (r) (2) either in 1932 or later. Our contention here that individual partners are not entitled to use the excess noncapital partnership gains to offset their individual noncapital losses, is, therefore, entirely consistent with the practice with respect to excess noncapital partnership losses.

The primary reliance of petitioner is upon the early case of *United States* v. *Coulby,* 258 Fed. 27 (C. C. A. 6th), affirming 251 Fed. 982 (N. D. Ohio). It presented the issue whether, under Section 2 (b) of the 1913 income tax statute, an individual partner in computing his net income for the purpose of the normal tax could deduct his distributive share of partnership profits to the extent such profits were attributable to dividends received by the firm upon the stock of a corporation which was taxable upon its net income. The decision, allowing such a deduction to the partner, turned upon the specific provisions of the 1913 Act. Under that Act, no return was required from the partnership, and no provision authorized the

exclusion of such dividends in the computation of partnership income. Accordingly, in order to carry out the intention of Congress to exclude from net income and thus from tax the dividends of corporations which likewise paid a net income tax, an adjustment was permitted in the computation of the individual partners. This decision was in accordance with the provision in the Revenue Act of 1916, specifically allowing a deduction by the individual partners, and the court reasoned that the later enactment was a legislative recognition of the scope and intent of the 1913 Act. It is evident, therefore, that the *Coulby* case, arising under an act which did not require a partnership return, did not raise the issue, now before this Court, whether an individual partner may personally take a deduction which is in addition to a like deduction specifically allowed to the partnership, as such. And, unlike the subsequent enactment considered in that case, the Act of 1938 furnishes substantial support for the position here advocated by the Government. See pp. 18-21, *supra*.

3. THE UNIFORM ADMINISTRATIVE AND JUDICIAL CONSTRUCTION OF SECTION 23 (e) AND (r) SUPPORTS THE GOVERNMENT

The precise issue raised in this case is a narrow one which arises only under Section 23 (e) and (r) of the Revenue Act of 1932. The Treasury Department has decided this issue and has denied the claimed deduction. G. C. M. 14012,

XIV–1 Cum. Bull. 145; IT 2892, *id.*, 148. It has never modified its position.

Every case raising this issue before a federal court has likewise resulted in a decision rejecting the claim to the deduction.[7] *Johnston* v. *Commissioner,* 34 B. T. A. 276, affirmed, 86 F. (2d) 732 (C. C. A. 2d), certiorari denied, 301 U. S. 683; *Klauber* v. *Commissioner,* 34 B. T. A. 998, affirmed, 92 F. (2d) 1007 (C. C. A. 2d); *Winmill* v. *Commissioner,* 93 F. (2d) 494, reversed on another point, 305 U. S. 79; *Sartorius* v. *Commissioner,* 35 B. T. A. 1233, dismissed without opinion, January 26, 1938 (C. C. A. 2d), certiorari denied, 301 U. S. 688; *Klingenstein* v. *United States,* 18 F. Supp. 1015 (C. Cls.), certiorari denied, 301 U. S. 716. See also *Davis* v. *United States,* 87 F. (2d) 323 (C. C. A. 2d), certiorari denied, 302 U. S. 704; *Cohn* v. *United States,* 23 F. Supp. 534 (C. Cls.); *White* v. *Commissioner,* 37 B. T. A. 1106.

The petitioner would avoid the force of this uniform administrative and judicial construction by arguing, in effect, that to allow noncapital security losses of an individual partner to be offset

[7] *Jennings* v. *Commissioner,* 110 F. (2d) 945 (C. C. A. 5th), now pending on petition for certiorari, No. 231, this Term, raises the issue whether, under the 1936 Act, individual gambling losses may be offset against partnership gambling gains. The Treasury had ruled against the taxpayer. G. C. M. 21478, 1939 CCH, Vol. 3, par. 6455. The court's approach in the *Jennings* case, however, is inconsistent with our position here.

against noncapital security gains of the partnership would not be inconsistent with the purpose of Section 23 (e) and (r). Specifically he urges that the legislative history of Section 23 (r) shows that the purpose of Congress was only to prevent the deduction of speculative security losses from salaries, dividends, rents, and similar income. See H. Rep. No. 708, 72d Cong., 1st Sess., p. 12; S. Rep. No. 665, 72d Cong., 1st Sess., p. 10. But while the basic purpose of Congress was doubtless to prevent noncapital security losses from being applied against such ordinary income, Congress did not relieve noncapital security gains from taxation except as deductions were available under the statute to offset them, and the noncapital security losses sustained by a partnership specifically were allowed as deductions to be offset against its noncapital gains. There is nothing in the legislative history of Section 23 (r), therefore, which lends any support to the position taken by the petitioner.

It is submitted that, under the circumstances, the uniform administrative and judicial construction of Section 23 (e) and (r) should be determinative. Additional support for this construction is found in the established rule that, in the absence of a clear and specific statutory authorization, a claim of right to a deduction from gross income must be denied. *New Colonial Co.* v. *Helvering,* 292 U. S. 435, 440; *Burnet* v. *Thompson Oil & G. Co.,* 283 U. S. 301.

II

THE ACT IS CONSTITUTIONAL AS APPLIED

It is important to observe that the claim advanced by petitioner is a claim to a deduction from gross income. Section 23 (e) and (r). Such a deduction, as this Court has repeatedly recognized, is a matter of legislative grace. *New Colonial Co.* v. *Helvering,* 292 U. S. 435, 440; *Helvering* v. *Ind. Life Ins. Co.,* 292 U. S. 371, 381; *Denman* v. *Slayton,* 282 U. S. 514. It follows that the conditions and limitations as to the manner of computing the deductions are within the complete discretion of Congress. Petitioner, who has received the benefit of a deduction specifically allowed, has no standing to protest that Congress should have been even more generous. Compare *Perkins* v. *Lukens Steel Co.,* 310 U. S. 113, 125; *Tennessee Electric Power Co.* v. *Tennessee Valley Authority,* 306 U. S. 118, 137–138; *Alabama Power Co.* v. *Ickes,* 302 U. S. 464; *Massachusetts* v. *Mellon,* 262 U. S. 447.

The application of the statute, in any event, does not violate any provision of the Constitution. All taxpayers similarly situated are treated alike. The legislative history of Section 23 (r) demonstrates that reasonable men might perceive that speculation in securities is productive of consequences differing from those arising from other types of speculation. See S. Rep. No. 665, 72d Cong., 1st Sess.; H. Rep. No.

708, 72d Cong., 1st Sess. Congress clearly may act on such differences. *United States* v. *Hudson*, 299 U. S. 498; *Barclay & Co.* v. *Edwards*, 267 U. S. 442, 450; *Billings* v. *United States*, 232 U. S. 261, 282. Compare *Tigner* v. *Texas*, 310 U. S. 141, 147.

CONCLUSION

It is respectfully submitted that, for the foregoing reasons, the decision of the court below should be affirmed.

FRANCIS BIDDLE,
Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
J. LOUIS MONARCH,
MAURICE J. MAHONEY,
Special Assistants to the Attorney General.
EDWIN E. HUDDLESTON, JR.,
Attorney.

OCTOBER 1940.

U. S. GOVERNMENT PRINTING OFFICE: 1940

APPENDIX

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) *Expenses.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * * *

(e) *Losses by Individuals.*—Subject to the limitations provided in subsection (r) of this section, in the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

(3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty,

or from theft. No loss shall be allowed as a deduction under this paragraph if at the time of the filing of the return such loss has been claimed as a deduction for estate-tax purposes in the estate-tax return.

* * * * *

(r) *Limitation on Stock Losses.*—

(1) Losses from sales or exchanges of stocks and bonds (as defined in subsection (t) of this section) which are not capital assets (as defined in section 101) shall be allowed only to the extent of the gains from such sales or exchanges (including gains which may be derived by a taxpayer from the retirement of his own obligations).

(2) Losses disallowed as a deduction by paragraph (1), computed without regard to any losses sustained during the preceding taxable year, shall, to an amount not in excess of the taxpayer's net income for the taxable year, be considered for the purposes of this title as losses sustained in the succeeding taxable year from sales or exchanges of stocks or bonds which are not capital assets.

(3) This subsection shall not apply to a dealer in securities (as to stocks and bonds acquired for resale to customers) in respect of transactions in the ordinary course of his business, nor to a bank or trust company incorporated under the laws of the United States or of any State or Territory, nor to persons carrying on the banking business (where the receipt of deposits constitutes a major part of such business) in respect of transactions in the ordinary course of such banking business.

(s) *Same—Short Sales.*—For the purposes of this title, gains or losses (A) from short sales of stocks and bonds, or (B) attributable to privileges or options to buy or

sell such stocks and bonds, or (C) from sales or exchanges of such privileges or options, shall be considered as gains or losses from sales or exchanges of stocks or bonds which are not capital assets.

(t) *Definition of Stocks and Bonds.*—As used in subsections (r) and (s), the term "stocks and bonds" means (1) shares of stock in any corporation, or (2) rights to subscribe for or to receive such shares, or (3) bonds, debentures, notes, or certificates or other evidences of indebtedness, issued by any corporation (other than a government or political subdivision thereof), with interest coupons or in registered form, or (4) certificates of profit, or of interest in property or accumulations, in any investment trust or similar organization holding or dealing in any of the instruments mentioned or described in this subsection, regardless of whether or not such investment trust or similar organization constitutes a corporation within the meaning of this Act.

SUPPLEMENT F—PARTNERSHIPS

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

SEC. 182. TAX OF PARTNERS.

(a) *General Rule.*—There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year. If the taxable year of a partner is different from that of the partnership, the amount so included shall be based upon the income of the partnership for any taxable year of the partnership ending within his taxable year.

* * * * * *

SEC. 183. COMPUTATION OF PARTNERSHIP INCOME.

The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except that the so-called charitable contribution deduction provided in section 23 (n) shall not be allowed.

SEC. 184. CREDITS AGAINST NET INCOME.

The partner shall, for the purpose of the normal tax, be allowed as a credit against his net income, in addition to the credits allowed to him under section 25, his proportionate share of such amounts of dividends and interest specified in section 25 (a) and (b) as are received by the partnership.

SEC. 185. EARNED INCOME.

In the case of the members of a partnership the proper part of each share of the net income which consists of earned income shall be determined under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary and shall be separately shown in the return of the partnership and shall be taxed to the member as provided in this Supplement.

SEC. 186. CAPITAL NET GAINS AND LOSSES.

In the case of the members of a partnership the proper part of each share of the net income which consists, respectively, of ordinary net income, capital net gain, or capital net loss, shall be determined under the rules and regulations to be prescribed by the Commissioner with the approval of the Secretary, and shall be separately shown in the return of the partnership and shall be taxed to the member as provided in this Supplement, but at the rates and in the manner provided in section 101 (a) and (b), relating to capital net gains and losses.

SEC. 187. NET LOSSES.

The benefit of the special deduction for net losses allowed by section 117 shall be allowed to the members of a partnership under regulations prescribed by the Commissioner with the approval of the Secretary.

SEC. 188. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF THE UNITED STATES.

The amount of income, war-profits, and excess-profits taxes imposed by foreign countries or possessions of the United States shall be allowed as a credit against the tax of the member of a partnership to the extent provided in section 131.

SEC. 189. PARTNERSHIP RETURNS.

Every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this title, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

(a) As a part of his short-term capital gains or losses, his distributive share of the net short-term capital gain or loss of the partnership.

(b) As a part of his long-term capital gains or losses, his distributive share of the net long-term capital gain or loss of the partnership.

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b).

SEC. 183. COMPUTATION OF PARTNERSHIP INCOME.

(a) GENERAL RULE.—The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except as provided in subsection (b) and (c).

(b) SEGREGATION OF ITEMS.—

(1) CAPITAL GAINS AND LOSSES.—There shall be segregated the short-term capital gains and losses and the long-term capital gains and losses, and the net short-term capital gain or loss and the net long-term capital gain or loss shall be computed.

(2) ORDINARY NET INCOME OR LOSS.—After excluding all items of either short-term or long-term capital gain or loss, there shall be computed—

(A) An ordinary net income which shall consist of the excess of the gross income over the deductions; or

(B) An ordinary net loss which shall consist of the excess of the deductions over the gross income.

Treasury Regulations 77, promulgated under the Revenue Act of 1932:

ART. 121. *Business expenses.*—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except the classes of items which are deductible under the provisions of articles 141–272. The cost of goods purchased for resale, with proper adjustment for opening and closing

inventories, is deducted from gross sales in computing gross income. (See article 55.) Among the items included in business expenses are management expenses, commissions, labor, supplies, incidental repairs, operating expenses of automobiles used in the trade or business, traveling expenses while away from home solely in the pursuit of a trade or business (see article 122), advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business, and rental for the use of business property. A taxpayer is entitled to deduct the necessary expenses paid in carrying on his business from his gross income from whatever source. As to items not deductible, see section 24 and articles 281–284.

ART. 282. *Capital expenditures.*—Amounts paid for increasing the capital value or for making good the depreciation for which a deduction has been made) of property are not deductible from gross income. (See section 23 (k) and article 201.) Amounts expended for securing a copyright and plates, which remain the property of the person making the payments, are investments of capital. The cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense. The amount expended for architects' services is part of the cost of the building. Commissions paid in purchasing securities are a part of the cost price of such securities. Commissions paid in selling securities, when such commissions are not an ordinary and necessary business expense, are an offset against the selling price. * * *

U. S. GOVERNMENT PRINTING OFFICE: 1940

FILE COPY

Office - Supreme Court, U. S.
FILED
FEB 23 1940
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1939.

No. [redacted] 5

HARRY H. NEUBERGER,

Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR REHEARING OF PETITION FOR CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Supplemental Memorandum for Petitioner.

JOSEPH M. PROSKAUER,
WALTER MENDELSOHN,
WILBUR H. FRIEDMAN,
Counsel for Petitioner.

THE COURT PRESS, N. Y. C.

INDEX.

PAGE

Supplemental Memorandum for Petitioner..... 1

I.—Conflict between the decision below and the *Craik* case with respect to the commission question 3

II.—Conflict between the decision below and the *Craik* case with respect to the security profits question 6

Conclusion 11

Appendix 13

TABLE OF CASES CITED:

Central Hanover Bank v. *Trust Co. et al., Executors* v. *United States*, No. 44896.....1, 2, 12

Crooks v. *Kansas City Title Co.*, 46 Fed. (2nd) 928.. 11

Griffiths v. *Helvering*, — U. S. —, decided Dec. 18, 1939 11

Helvering v. *Winmill*, 305 U. S. 79..... 3

Higgins v. *Smith*, — U. S. —, decided Jan. 8, 1940... 11

John Craik v. *United States*, No. M-79, Court of Claims 1, 2, 4, 5, 6, 7, 8, 10, 11, 12, 13

Johnston v. *Commissioner*, 86 F. (2d) 732...2, 6, 8, 9, 10, 11

Real Estate Land Title Co. v. *United States*, — U. S. —, decided Jan. 15, 1940..... 11

United States v. *Coulby*, 258 Fed. 27..... 12

OTHER AUTHORITY CITED:

Revenue Act of 1932
Section 23(r)..... 7

IN THE

Supreme Court of the United States

OCTOBER TERM, 1939.

No. 548.

HARRY H. NEUBERGER,

Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR REHEARING OF PETITION FOR CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Supplemental Memorandum for Petitioner.

After the denial of certiorari in this case, a petition for rehearing was filed, together with a motion to defer consideration of the petition for rehearing until the decision of a pending case in the Court of Claims involving identical issues. The Court has not yet acted on the petition for rehearing or the motion to defer consideration thereof.

On February 5, 1940 the Court of Claims decided the case of *John Craik* v. *United States,* believed to be in conflict with the decision below and reprinted in full in appendix (*infra,* pp. 13-20). (The *Craik* case is not the case referred to in the petition for rehearing, which has not yet been decided by the Court of Claims. *Central Hanover Bank & Trust Co., et al., Executors* v. *United States.*) The *Craik* case was

called to the attention of this Court on February 10th, and on February 12th petitioner was notified by the Clerk that this supplemental memorandum would be received.

The conflict between the *Craik* case and the decision below is indicated by the following excerpts from the opinions of the Court of Claims and of the court below in *Johnston* v. *Commissioner* 86 F. (2d) 732, the Court below having decided this case on the authority of its earlier decision by a divided Court (Judge Swan dissenting) in the *Johnston* case:

Craik (Court of Claims).	*Johnston* (Second Circuit).
"We are convinced that Congress intended that partnership income should be treated as though it had been received by the partners individually. If we are correct in this, then this plaintiff's proportionate share of the partnership income received from sources without the United States should be treated as though he himself had received this income directly, and not through the conduit of the partnership."	"* * * when the partnership return shows net income, a partner's distributive share is to be entered in his own return as his own income derived from the partnership without retaining the peculiar character it had in the partnership return unless Congress has expressly so provided and then only for the purpose stated."

It is respectfully submitted that the Court should now grant certiorari without waiting for the decision of the Court of Claims in the *Central Hanover* case.

I.

Conflict between the decision below and the *Craik* case with respect to the commission question.

On this point the facts are briefly as follows: During 1932 petitioner, a member of the New York Stock Exchange whose business was trading in securities for himself, for his partnership and for its customers, paid commissions on the purchase of securities to his partnership. These commissions were included by the partnership in its income tax return and 45% of the commissions, that being petitioner's share of his firm's income, were in turn included in petitioner's own income tax return and taxed to him. Petitioner sought deduction of the entire amount of purchase commissions paid in 1932 as an expense of his business of trading in securities. After the Board's decision allowing such deduction, this Court decided that, under Regulations of the Commissioner of long standing, purchase commissions were not deductible as such. *Helvering* v. *Winmill,* 305 U. S. 79.

In the Circuit Court of Appeals, petitioner contended that he should not be subjected to an income tax on that share of the purchase commissions which were repaid to him in the same year in his distributive share of the partnership income, since to that extent he had in effect paid the commissions to himself, and if not deductible as commissions paid, the portion returned to him should not be taxed as income received. The Government, arguing that the commissions lost their identity when received by the partnership and that petitioner was taxable on his full distributive share without reference to the sources of the partnership income, was sustained.

The rule of the *Craik* case is summarized by the Court of Claims thus:

> "An examination of the various income tax Acts, beginning with the first one of 1913, shows that Congress in the enactment of each of them intended to treat partnership income as though the distributive share of each partner therein had been received *directly* by the partner." (Emphasis supplied.)

Under this rule petitioner here must be deemed to have received directly from himself 45% of the purchase commissions, that being his share of the firm's income, and of course he should not be subjected to income tax on his own money. The decision of the Court below to the contrary cannot be reconciled with the *Craik* case.

The rule of the *Craik* case quoted above was no casual dictum. It was the heart of the decision. Craik was a member of a domestic partnership which received income from domestic and foreign sources. Being a non-resident alien, Craik would not have been taxable upon foreign income received by him directly. However, the partnership provisions of the Federal Income Tax Law provided that every partner should be taxable on "his distributive share, whether distributed or not, of the net income of the partnership for the taxable year".

There was no provision exempting non-resident alien members of domestic partnerships from income tax on that part of the partnership income derived from foreign sources.

Thus the Court of Claims was squarely presented in the *Craik* case with the question whether partners may be deemed to have received directly their proportionate shares of each item of the partnership income received by the partnership even in the absence of any provision in the Income Tax Law to that effect. In so holding, the Court of Claims pointed out:

> "The income earned by the partnership was regarded as having been earned by each of the individual partners, either by himself individually or through his agents, the other partners.
>
> "The Bureau of Internal Revenue has so treated partnership income for twenty years. Originally it promulgated a regulation providing that partnership income could not be traced to its source behind the partnership for the purpose of claiming individual exemption. This ruling, however, was questioned and presented to the District Court for the Northern District of Ohio. On June 26, 1918, the Court rendered an opinion holding that the Revenue Acts treat a partnership's—
>
> > '* * * profits and its earnings as those of the individual taxpayer. * * * The Congress, consequently, it would seem, ignored, for taxing purposes, a partnership's existence, and placed the individual partner's share in its gains and profits on the same footing as if his income had been received directly by him without the intervention of a partnership name' (251 Fed. 982).
>
> "This case was affirmed on appeal. *United States* v. *Coulby*, 258 Fed. 27.

> "It is admitted that since this time partnership income has been so treated by the Bureau. In the light of this administrative practice Congress has continued to enact substantially the same provisions for the treatment of partnership income."

Had the court below applied the same rule, it could not have taxed petitioner on his proportionate share of the purchase commissions, since, under the *Craik* case, petitioner must be deemed to have paid these commissions directly to himself to the extent of his 45% interest in the partnership. No one has yet suggested that the income tax goes so far as to tax an individual on the transfer of his own funds from one of his pockets to another.

II.

Conflict between the decision below and the *Craik* case with respect to the security profits question.

In the course of his business of trading in securities for himself and for his partnership, petitioner realized individual losses in 1932 upon the sale of securities held less than two years. For his partnership, his trading produced profits on the sale of securities held less than two years. On his return, petitioner sought to set off his individual security losses against his share of the partnership's security profits. The court below held that he could not do this, citing its prior decision by a divided court (Judge Swan dissenting) in *Johnston* v. *Commissioner,* 86 F. (2d) 732.

Before 1932 losses on securities held less than two years were fully deductible from all types of income,

including a partner's share of his firm's security profits. In 1932, the statute was amended in Section 23(r) to provide that losses from sales of securities held less than two years shall be allowed only to the extent of profits from such sales. If petitioner had realized directly his share of his partnership's security profits in 1932, the 1932 law would have permitted him to reduce the profits by the losses. Petitioner took the position that, to the extent of his interest in his partnership, he was entitled to consider its security profits as being his. In this view his share of the partnership's security profits and his individual security losses could be segregated together, only the excess profits being subjected to income tax.

The Commissioner said that this could not be done, urging that, in the absence of a specific provision authorizing a partner to treat his share of the partnership income as having been received directly by him, the partnership income lost its character and became general income. As general income, its component parts could not be lumped with the component items on the individual's return.

This was a departure from the twenty year old administrative practice of the Bureau (referred to in the *Craik* case) of treating the partner's share of the firm's items of income as having been received directly by him. It was not justified by any specific provision in the 1932 Act. Section 23(r), which limited security losses to security profits, made no reference to partnerships, and the partnership sections of the Income Tax Law were carried over from the earlier Acts into the 1932 Act without change. Nevertheless the court below, Judge Swan dissenting,

accepted the Commissioner's view, and held in the *Johnston* case (86 F. (2d) at 734):

> "* * * when the partnership return shows net income, a partner's distributive share is to be entered in his own return as his own income derived from the partnership without retaining the peculiar character it had in the partnership return unless Congress has expressly so provided and then only for the purpose stated."

Since the decision of the Court below in the instant case was rendered *per curiam* on the authority of the *Johnston* case, it is clear that on this point as well as on the commission point there is a direct conflict with the *Craik* case. It is true that in the *Craik* case the Court made a half-hearted attempt to justify the *Johnston* decision. It is submitted, however, that the attempt is hollow, and that, read as a whole, the opinion in the *Craik* case cannot be squared with the *Johnston* decision. The Court of Claims said:

> "The Court [in the *Johnston* case] thought that Congress, by providing for certain specific credits against a partner's income on account of his share of partnership profits, thereby impliedly prohibited any other credit. The Court called attention to the fact that the Act expressly provided for taxing the partners on their distributive share of capital net gains as if it had been received by them individually, and thought that its failure to mention noncapital gains and losses indicated that it did not intend that they should be treated similarly. This case was followed by this court in *Klingenstein* v. *United States,* 85 C. Cls., 164; 18 F. Supp. 1015.
>
> "Congress' attention having been given to

gains and losses, and having provided for the treatment of capital gains and losses as if they were the gains and losses of the individual partners, and not having made such provision for noncapital gains and losses, there was room for the conclusion reached in the *Johnston* case, *supra.*"

Having said so much, the Court then proceeded to demolish its support of the *Johnston* case as follows:

"But we do not think that by the specification of certain items for which the partner might take credit Congress intended to exclude all others, if the exclusion of them would result in the treatment of partnership income in a way different from what it would have been treated had it been received by the partners individually.

"It is, of course, within the power of Congress to limit deductions from gross income to any extent it pleases, but our study of the pertinent sections of the 1916 and 1918 Acts and of related sections of other acts persuades us that Congress intended that an individual should have every deduction from partnership income which he might take from his individual income, unless the contrary clearly appears.

"However, we are dealing here not with what credits or deductions a partner is entitled to, but what he shall include in his gross income. We are convinced that Congress intended that partnership income should be treated as though it had been received by the partners individually. If we are correct in this, then this plaintiff's proportionate share of the partnership income received from sources without the United States

should be treated as though he himself had received this income directly, and not through the conduit of the partnership. If so, in computing his income, his proportionate share of the income from sources without the United States should be excluded.

"The defendant further takes the position in its brief that the plaintiff received his income from the partnership, and since the partnership was a 'domestic partnership' his income was from sources within the United States, from whatever source the income might have been derived by the partnership. This cannot be true unless the partnership is regarded as a separate entity, and this the Revenue Act does not do. (*Cf. Dorothy S. Bence* v. *United States,* 84 C. Cls., 605; 18 F. Supp. 848.)"

Just how squarely the *Craik* and *Johnston* cases are in conflict is shown by the following two subjoining excerpts from the opinions of the two Courts, each setting forth in one sentence the basis of its holding:

Craik

"It is, of course, within the power of Congress to limit deductions from gross income to any extent it pleases, but our study of the pertinent sections of the 1916 and 1918 Acts and of related sections of other acts persuades us that Congress intended that an individ-

Johnston

"* * * when the partnership return shows net income, a partner's distributive share is to be entered in his own return as his own income derived from the partnership without retaining the peculiar character it had in the partnership return unless Congress has ex-

Craik	*Johnston*
ual should have *every* deduction from partnership income which he might take from his individual income, unless the contrary clearly appears." (Emphasis supplied.)	pressly so provided and then only for the purpose stated."

If the Court of Claims had believed that the argument in the *Johnston* case was sound that a partner should not be given credit for his share of specific items of the partnership income except where the Revenue Act expressly so provided, it could not have held for the plaintiff in the *Craik* case, since there was no specific provision in the Act giving a nonresident alien partner credit for his share of the partnership's foreign income while there were specific provisions in the Act giving a partner credit for his share of various other kinds of partnership income, such as dividends and Government bond interest.

It is submitted that the conflict in the present case is no less sharp and of no less importance than other tax cases in which certiorari was granted this Term, such as *Higgins* v. *Smith* (a loss case; conflict with *Griffiths* v. *Helvering,* a gain case) and *Real Estate Land Title Co.* v. *United States* (obsolescence through voluntary disuse; conflict asserted with *Crooks* v. *Kansas City Title Co.,* obsolescence through functional inefficiency).

Conclusion.

It is submitted that the *Craik* case is in conflict with the decision below with respect to the proper

treatment for Federal income tax purposes of partnership income. As pointed out in the petition for certiorari in this case, at least seven different situations have arisen in which the question how to treat partnership income on the individual partners' returns is decisive. The *Craik* case represents an eighth situation not mentioned in the petition for certiorari, and no doubt there are others. Since the decision below conflicts with uniform administrative practice for twenty years and conflicts with the decisions both of the Court of Claims and of the Sixth Circuit (in the *Coulby* case) with regard to the treatment of partnership income, it is submitted that certiorari should be granted now.

However, if the Court is not inclined to grant certiorari at this time, petitioner respectfully moves that the Court defer consideration of the petition for rehearing until the decision of the Court of Claims in the *Central Hanover Bank* case, which raises the identical questions regarding commissions and security profits which are in the instant case. Counsel for the petitioner here has discussed the *Central Hanover* case with Government counsel, and is authorized to state that every effort is being made to have the *Central Hanover* case argued before the Court of Claims at its April sitting. If the Court prefers to withhold action on the petition for rehearing herein until the decision in the *Central Hanover* case, the Government will not be prejudiced by the delay since the tax in this case has been paid.

Respectfully submitted,

JOSEPH M. PROSKAUER,
WALTER MENDELSOHN,
WILBUR H. FRIEDMAN,
Counsel for Petitioner.

February, 1940.

Appendix.

John Craik v. *U. S.*

(U. S. Court of Claims, No. M-79, February 5, 1940)

OPINION

Whitaker, Judge, delivered the opinion of the court:

The plaintiff during the time in question was a nonresident alien. He was a member of two partnerships operating in this country. Both of these partnerships derived a portion of their income from sources without the United States. The plaintiff, being a nonresident alien, claims the right to exclude from his income his distributive share of the partnership income derived from sources without the United States, under section 213(c) of the Revenue Act of 1918, which reads in part as follows:

> "In the case of nonresident alien individuals, gross income includes only the gross income from sources within the United States, * * *"

and a similar provision of the Revenue Act of 1916 [section 1(a)].

The provisions of the Revenue Act of 1916, as amended, and of the Act of 1918 applicable here are substantially the same. Section 218(a) of the Revenue Act of 1918 provides:

> That individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

It then provides that each partner, in computing his net income, shall include "his distributive share, whether dis-

tributed or not, of the net income of the partnership * * *."

In subsection (d) the method of computing the net income of the partnership is prescribed. It is provided that it "shall be computed in the same manner and on the same basis as provided in section 212, except that the deduction provided in paragraph (11) of subdivision (a) of section 214 shall not be allowed." The paragraph referred to is that permitting deductions for charitable and similar contributions.

Since the partnership in computing its net income was required to include, as was an individual, dividends received from corporations and interest on United States obligations, and since an individual in computing his income subject to normal tax was entitled to deduct such items, it was provided that a partner might deduct from his income his proportionate share of such interest and dividends received by the partnership.

An examination of the various income tax Acts, beginning with the first one of 1913, shows that Congress in the enactment of each of them intended to treat partnership income as though the distributive share of each partner therein had been received directly by the partner. Each one of the Acts contains the statement that "individuals carrying on business in partnership shall be liable for income tax only in their individual capacity," and each one of them allows the partner the same credit against partnership income to which he was entitled against his individual income.

The 1913 Act did not in terms allow the credits allowed by the 1918 Act. This, undoubtedly, was because Congress had the common-law view of a partnership and, therefore, did not think it necessary to enact such an ex-

press provision, assuming that it would be understood that the income of the partnership was intended to be treated as that of the individual partners.

In the enactment of the Revenue Act of 1916, however, Congress made express provision for the exclusion from the individual partner's income of that part of his proportionate share of the partnership income which would have been excluded had the income been received by him individually, such as interest on United States obligations, or those of a State or political subdivision thereof, taxes paid to the United States, or to any State or political subdivision, and their proportionate share of dividends received by the partnership; thus more fully expressing its intent that the partnership should not be treated as a separate entity, but that income received by it should be treated as income received by the individual partner.

A different method for the handling of partnership income was provided for in the 1918 Act. By that Act rules were laid down for the computation of the partnership income, whereas none had been in either the 1913 or 1916 Acts. A partnership was required to compute its income as did an individual, but in order to treat the partner's distributive share thereof on the same basis as his individual income, the credit for his proportionate share of dividends and interest on United States obligations was expressly allowed him. This indicates to us again that Congress intended to treat partnership income as income received by the individual partners.

The 1921, 1924 and 1926 Acts contained the same provisions as the 1918 Act.

The 1928 Act allowed an individual credit for earned income and allowed him to compute capital net gains and

losses on a basis different from ordinary gains and losses. So, continuing its policy of treating a partner's distributive share of partnership income on the same basis as income received by him individually, it was provided that a partner should be entitled to credit for his proper part of the partnership's earned income, and that his proper part of the partnership's capital net gains and losses and of its ordinary net income should be taxable to him as though they had been received by him directly. The partner was also permitted to deduct his proportionate share of the net loss of the partnership and his proportionate share of income, war-profits, and excess-profits taxes paid foreign countries.

The 1932 Act was to the same effect.

Only in one respect might it be said that Congress had evinced a purpose not to treat partnership income as income received by the individual partners. That is, that partnerships in computing their income were not entitled to deduct charitable contributions; whereas individuals were. But the Bureau of Internal Revenue held, after this restriction had been placed on partnerships in the 1918 Act, that the respective partners were entitled to the deduction in computing their individual income. O.D. 185, 1 C.B. 151. After this ruling was made Congress enacted the 1921, 1924, 1926, 1928, and 1932 Acts and made no change in the law, thus evidencing its approval of this ruling, and thus further evidencing its intention that a partner's distributive share should be treated as though it had been received by him individually.

In the 1934 and 1936 Acts the prohibition against the deduction of charitable contributions in computing the income of partnerships was eliminated. The 1938 Act prohibited the deduction to the partnership, but per-

mitted the partners to deduct their proportionate share, going back to the practice established when the 1918 Act was passed.

The treatment of partnership income on the same basis as though it had been received by the partner directly is consistent with the common-law idea of a partnership. At common law, the personal property of the partnership was held not by the partnership, but by the partners in common. Real estate was held by an individual for the benefit of the partnership, because a partnership was not an entity and, therefore, could not hold the title. Each partner was liable for the debts of the partnership on the theory that they were the partners' debts and not the debts of the partnership. Each partner was the agent for the other partners in the carrying out of their common purpose. The income earned by the partnership was regarded as having been earned by each of the individual partners, either by himself individually or through his agents, the other partners.

The Bureau of Internal Revenue has so treated partnership income for twenty years. Originally it promulgated a regulation providing that partnership income could not be traced to its source behind the partnership for the purpose of claiming individual exemption. This ruling, however, was questioned and presented to the District Court for the Northern District of Ohio. On June 26, 1918, the court rendered an opinion holding that the Revenue Acts treat a partnership's—

> * * * profits and its earnings as those of the individual taxpayer. * * * The Congress, consequently, it would seem, ignored, for taxing purposes, a partnership's existence, and placed the individual partner's share in its gains and profits on the same foot-

> ing as if his income had been received directly by him without the intervention of a partnership name. (251 Fed. 982.)

This case was affirmed on appeal. *United States* v. *Coulby*, 258 Fed. 27.

It is admitted that since this time partnership income has been so treated by the Bureau. In the light of this administrative practice Congress has continued to enact substantially the same provisions for the treatment of partnership income.

The defendant, however, presses upon us the decision of the Second Circuit Court of Appeals in *Johnston* v. *Commissioner of Internal Revenue*, 86 F. (2d) 732 [18 A.F.T.R. 662], Circuit Judge Swan dissenting. In that case the majority of the court held that a partner was not permitted to offset his noncapital net loss against his proportionate share of the partnership net gain. The Court thought that Congress, by providing for certain specific credits against a partner's income on account of his share of partnership profits, thereby impliedly prohibited any other credit. The Court called attention to the fact that the Act expressly provided for taxing the partners on their distributive share of capital net gains as if it had been received by them individually, and thought that its failure to mention noncapital gains and losses indicated that it did not intend that they should be treated similarly. This case was followed by this court in *Klingenstein* v. *United States*, 85 C. Cls., 164; 18 F. Supp. 1015.

Congress' attention having been given to gains and losses, and having provided for the treatment of capital gains and losses as if they were the gains and losses of the individual partners, and not having made such pro-

vision for noncapital gains and losses, there was room for the conclusion reached in the *Johnston* case, *supra*. But we do not think that by the specification of certain items for which the partner might take credit Congress intended to exclude all others, if the exclusion of them would result in the treatment of partnership income in a way different from what it would have been treated had it been received by the partners individually.

It is, of course, within the power of Congress to limit deductions from gross income to any extent it pleases, but our study of the pertinent sections of the 1916 and 1918 Acts and of related sections of other acts persuades us that Congress intended that an individual should have every deduction from partnership income which he might take from his individual income, unless the contrary clearly appears.

However, we are dealing here not with what credits or deductions a partner is entitled to, but what he shall include in his gross income. We are convinced that Congress intended that partnership income should be treated as though it had been received by the partners individually. If we are correct in this, then this plaintiff's proportionate share of the partnership income received from sources without the United States should be treated as though he himself had received this income directly, and not through the conduit of the partnership. If so, in computing his income, his proportionate share of the income from sources without the United States should be excluded.

The defendant further takes the position in its brief that the plaintiff received his income from the partnership, and since the partnership was a "domestic partnership" his income was from sources within the United

States, from whatever source the income might have been derived by the partnership. This cannot be true unless the partnership is regarded as a separate entity, and this the Revenue Act does not do. (Cf. *Dorothy S. Bence* v. *United States,* 84 C. Cls., 605; 18 F. Supp. 848.)

It results that the plaintiff is entitled to recover the amounts stipulated, to wit: $2,671.65 with interest at 6 percent from June 15, 1918; $6,508.14 with interest at 6 percent from December 15, 1919; and $2,186.15 with interest at 6 percent from December 15, 1920. It is so ordered.

Williams, Judge; Littleton, Judge; Green, Judge; and Whaley, Chief Justice, concur.

FILE COPY

Office - Supreme Court, U. S.
FILED
MAR 1 1940
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1939.

No. [redacted] 5

HARRY H. NEUBERGER,

Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR REHEARING OF PETITION FOR CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Second Supplemental Memorandum for Petitioner.

JOSEPH M. PROSKAUER,
WALTER MENDELSOHN,
WILBUR H. FRIEDMAN,
Counsel for Petitioner.

THE COURT PRESS, N. Y. C.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1939.

No. 548.

HARRY H. NEUBERGER,

Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR REHEARING OF PETITION FOR CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Second Supplemental Memorandum for Petitioner.

Petitioner regrets the necessity of burdening this Court with an additional memorandum, but since the memorandum filed by the respondent in this case implies that the petitioner has withheld information from the Court in failing to call attention to the decision of the Court of Claims on January 8, 1940 in *Mosbacher* v. *United States,* leave is respectfully requested to file a second supplemental memorandum.

There is nothing in the *Mosbacher* case which detracts from petitioner's contention that the decision of the Court of Claims in the *Craik* case foreshadows a favorable decision in the *Central Hanover* case. The *Craik* case, in a careful opinion, took the position that partnership income must be deemed to have been re-

ceived by the partners directly. One of the issues common to the *Central Hanover* and *Neuberger* cases is whether a partner is entitled to credit for that portion of the partnership's commission income represented by commissions he himself paid to the partnership. The Court of Claims appears never to have decided this question, it was not involved in the *Mosbacher* case, and the decision in the *Craik* case appears to require the conclusion that such credit be allowed.

As one of the issues involved in the instant case was not presented in the *Mosbacher* case at all, the Government is not justified in saying "that the precise question involved in the present case was decided against petitioner's position by the Court of Claims less than a month prior to the decision in the *Craik* case. *Mosbacher* v. *United States*".

Moreover, Judge Whitaker, who wrote the opinion in both the *Mosbacher* and *Craik* cases, appears not to have thought that the *Mosbacher* case required decision of either of the present issues. His statement of the issue in the *Mosbacher* case follows:

> "In this case plaintiff seeks to offset certain losses which he claims he sustained in trading on the New York Curb Exchange against his profits therefrom. The issue is whether the losses were sustained by him individually or by an alleged partnership or joint venture of which plaintiff was a member."

The only issue tried was whether the transactions in question were partnership or individual transactions. While the plaintiff in the *Mosbacher* case might have argued that the security transactions should be reflected in his individual return even though they were partnership transactions (that being one of the

questions in the instant case), he did not do so, and the Court was not asked to decide the point.

There was no discussion of the question believed to be decisive here, as to whether partnership income retains its identity in the hands of the partners. The *Mosbacher* case was not referred to in the *Craik* case, which followed it by less than a month, and in which the Court of Claims for the first time reviewed the law relative to the nature for tax purposes of partnership income.

Petitioner reiterates his contention that the treatment of partnership income as retaining its identity in the hands of the partners in the *Craik* case is in conflict with the treatment of the partnership commission and security items in the *Neuberger* case, and that therefore certiorari should be granted. In the alternative, the Court is requested to defer action on the petition for rehearing in this case until the Court of Claims decides the *Central Hanover* case.

Respectfully submitted,

JOSEPH M. PROSKAUER,
WALTER MENDELSOHN,
WILBUR H. FRIEDMAN,
Counsel for Petitioner.

February, 1940.

FILE COPY

Office - Supreme Court, U. S.
FILED
JAN 27 1940
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1939.

No. [redacted] 5

HARRY H. NEUBERGER,

Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

PETITION FOR REHEARING AND MOTION TO DEFER CONSIDERATION OF PETITION FOR REHEARING.

JOSEPH M. PROSKAUER,
WALTER MENDELSOHN,
WILBUR H. FRIEDMAN,
Attorneys for Petitioner.

THE COURT PRESS, N. Y. C.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1939.

No. 548.

HARRY H. NEUBERGER,

Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

PETITION FOR REHEARING AND MOTION TO DEFER CONSIDERATION OF PETITION FOR REHEARING.

This is a petition for rehearing of a petition for a writ of certiorari which was denied by this Court on January 2, 1940.

The reason for this petition is that there is now pending in the United States Court of Claims the case of Central Hanover Bank & Trust Company, Herbert J. Marx and William L. Hernstadt, Executors of the Estate of Leopold Newborg, Deceased, against the United States of America, Docket No. 44896,

which, like the instant case, arises under the 1932 Act.

Both cases involve the question of

(1) The deductibility of individual trading losses against partnership security profits, and

(2) the deductibility of purchase commissions by a trader in securities to the extent that such purchase commissions are paid by the taxpayer to his own partnership and refunded to him.

In the event that the Court of Claims decides either of the above issues in favor of the plaintiff, a conflict will arise, which it is believed would justify this Court in granting certiorari. Rule 33 of this Court's Rules requires petitions for rehearings to be filed within twenty-five days. Said twenty-five days would expire on January 27, 1940. While the Court has power to grant a petition for rehearing of a petition for certiorari notwithstanding the failure to file a petition within the twenty-five day period (*Douglas* v. *Willcuts*, 295 U. S. 722; Robertson & Kirkham, Jurisdiction of the Supreme Court of the United States, p. 552), this petition is filed to eliminate any question as to the time element.

Counsel respectfully move that the Court defer consideration of this petition until the decision in the Court of Claims case above referred to.

Authority for deferment of action on this petition may be found in cases where action on petitions for certiorari was withheld pending decisions in other cases in other Courts. *American Surety Co.* v.

Baldwin, 287 U. S. 156, 163; *Michalek* v. *United States Gypsum Co.*, 298 U. S. 639; Robertson & Kirkham, *ibid*, page 559.

No prejudice can result to the Government from the postponement of action on this petition for rehearing since the tax in controversy has been paid.

Respectfully submitted,

JOSEPH M. PROSKAUER,
WALTER MENDELSOHN,
WILBUR H. FRIEDMAN,
Attorneys for Petitioner.

January, 1940.

Certificate of Counsel.

State of New York,
County of New York—ss.:

WILBUR H. FRIEDMAN, being duly sworn, deposes and says:

I am one of the attorneys for the petitioner herein, and am familiar with the facts of this case.

I hereby certify that the foregoing petition for rehearing and motion to defer consideration thereof are not made for the purpose of delay. The petition and motion are filed in good faith in the belief that substantial ground therefor exists.

WILBUR H. FRIEDMAN.

Sworn to before me this
26th day of January, 1940.

MARCIA C. MORSE,
Notary Public.
N. Y. Co. Clk's. No. 246. Reg. No. 0M346.
My Commission expires March 30, 1940.

(Seal)

BLANK PAGE

BLANK PAGE

FILE COPY

Office - Supreme Court, U. S.
FILED
MAY 24 1940
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

October Term 1939

No. [redacted] 5

HARRY H. NEUBERGER,

Petitioner,

—*against*—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR REHEARING OF PETITION FOR CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

Suggestion of New Conflict Warranting Certiorari and Alternative Motion to Defer Consideration of the Petition for Rehearing until the Fall Term

JOSEPH M. PROSKAUER,
WALTER MENDELSOHN,
WILBUR H. FRIEDMAN,
Counsel for Petitioner.

May, 1940.

IN THE

Supreme Court of the United States

October Term 1939

No. 548

HARRY H. NEUBERGER,

Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR REHEARING OF PETITION FOR CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

Suggestion of New Conflict Warranting Certiorari and Alternative Motion to Defer Consideration of the Petition for Rehearing until the Fall Term

---

POINT I.

Suggestion of new conflict warranting present grant of certiorari.

This case is pending on petition for rehearing of petition for certiorari and on motion to defer consideration of the petition for rehearing until the decision of a pending case in the Court of Claims involving the same questions (*Central Hanover Bank & Trust Co., et al., Executors* v. *United States*).

The Circuit Court of Appeals for the Fifth Circuit has recently decided the case of *Zelda Baker Jennings, et al.* v. *Commissioner of Internal Revenue* (printed in full in the appendix), in conflict with the decision in this case. It is believed that the Court is warranted in granting certiorari now on the basis of this conflict without waiting for the decision in the *Central Hanover* case.

One of the issues in this case is whether partnership security profits retain their identity on the partner's individual income tax return so as to enable him to offset against them his individual security losses, under a statute limiting the deductibility of security losses to security profits. The Court below, following its earlier decision by a divided Court in the *Johnston* case (86 F. (2d) 732), denied this right. The stated ground of the *Johnston* decision was that partnership income does not retain its identity in the partner's individual return unless Congress has expressly so provided.

In the *Jennings* case, the taxpayer sought to offset individual gambling losses against her share of partnership gambling gains. Section 23(g) of the 1936 Revenue Act provided that losses from wagering transactions are allowable only to the extent of the gains from such transactions, just as §23(r) of the 1932 Act (here in question) provided that non-capital security losses are allowable only to the extent of non-capital security gains. There was no provision in the 1936 Act that partnership wagering gains retain their identity in the partner's hands.

The Board of Tax Appeals, following the decision of the Second Circuit in the *Johnston* case, held that the partnership wagering gains lost their identity when distributed to the partner, and that the individual wagering losses could not be offset against the partnership wagering gains. The Circuit Court of Appeals reversed. The majority cited the

Sixth Circuit decision in the *Coulby* case (258 F. 27), where it had been held that partnership dividend income retained its identity as such in the partner's hands despite the absence of any provision in the statute to that effect, and said:

> "The partnership return is for information, and to secure uniformity and save repetition in the individual returns. It ascertains each partner's gain and apportions it to him to be taxed, whether distributed or not. It does not transform his share in the gain. If 'individuals carrying on business in partnership,' to use the phrase of the statute, make gains in wagering transactions, the share of each is a wagering gain; and when it is entered on his individual return to be taxed, a deduction of his losses in other wagering transactions is allowed by the statute, but only to the extent of such gains."

This, of course, is precisely the opposite from the general rule adopted by the Second Circuit in the *Johnston* case. The Fifth Circuit referred to the fact that the *Johnston* case dealt with a different statutory provision, which provision had been amended; but in 1932, the year here in question, the statute provided that non-capital security losses could be offset only against non-capital security profits, just as the statute in the *Jennings* case provided that gambling losses could be offset only against gambling profits. The amendment to which the Fifth Circuit refers was passed in 1933, effective as of January 1, 1933 (§218(d) of the National Industrial Recovery Act). It provided that partnership security losses could not be offset against individual security profits (the converse of the question in this case). It was passed as a result of the Senate Finance Committee Investigation of Stock Exchange practices, which disclosed that during the depression years partners of pri-

vate banking houses had paid no personal income tax by virtue of the application of partnership security losses against their individual incomes, an evil which the National Industrial Recovery Act sought to correct. But there has never been any provision, either by amendment or otherwise, denying to a partner the right to offset his individual security losses against his partnership security profits; and in 1932, the provision regarding the offset of security losses against security profits was the same as the 1936 provision dealing with wagering gains and losses.

The dissenting judge in the *Jennings* case thought the *Johnston* case controlling, saying:

> "An identical question of statutory construction was presented to the court in *Johnston* v. *Commissioner, supra,* the only difference being that this case involves Section 23(g), which relates to wagering losses, while the *Johnston* case involved Section 23(r), which limited the deduction of losses sustained on the sale of non-capital assets in relation to the gains from such sales. It is true, there was a dissent in that case, and the majority opinion here follows in principle the reasoning of that dissent, though this is a weaker case for the application of the principle, as a gambling partnership is not entitled to legislative encouragement as is a legitimate business."

Thus we find that, in the absence of statutory provision, the Sixth Circuit in the *Coulby* case (dividend income), the Fifth Circuit in the *Jennings* case (wagering income) and the Court of Claims in the *Craik* case (income from foreign sources, 31 Fed. Supp. 132) have all held that partnership income retains its identity in the partner's hands. The decision of the Court below that partnership security profits do not retain their identity in the partner's hands is in conflict with these decisions, and for this reason, certiorari should now be granted.

POINT II.

Alternative motion to defer decision of petition for rehearing until the Fall Term.

Petitioner has asked this Court to defer consideration of the petition for rehearing of the petition for certiorari until the decision by the Court of Claims in the *Central Hanover* case. That case was argued in the Court of Claims on May 8, 1940, and it is not likely that it will be decided before this Term of this Court ends. If the Court is not inclined to grant certiorari for the reasons set forth in Point I above, petitioner respectfully moves that decision on the petition for rehearing be postponed until the Fall Term. No prejudice can result to the Government from such a postponement since the tax in this case has been paid, and the request for postponement would appear to be meritorious in view of the state of the law as disclosed in Point I.

Respectfully submitted,

JOSEPH M. PROSKAUER,
WALTER MENDELSOHN,
WILBUR H. FRIEDMAN,
Counsel for Petitioner.

May, 1940.

Appendix.

Zeida Baker Jennings, et al., Petitioners v. *Commissioner of Internal Revenue*, Respondent.

United States Circuit Court of Appeals for the Fifth Circuit. No. 9383. Decided April 11, 1940.

Petition for review of decision of Board of Tax Appeals.

Before Sibley, Hutcheson & Holmes, Circuit Judges.

SIBLEY, Circuit Judge: We think the Board of Tax Appeals wrongly refused to allow the petitioners to deduct individual losses in gambling from gambling gains made in partnership, on redetermining their several income taxes for the year 1936. The facts were stipulated. The Board found: "The distributive share of each petitioner of partnership gains from gambling operations exceeded the amount of losses by petitioners in their individual gambling operations." The Revenue Act of 1936, Sect. 23(g), referring to deductions, provides: "Losses from wagering transactions shall be allowed only to the extent of the gains from such transactions." The Board thought the partnership in making up its return could offset its wagering losses against its wagering gains, and each partner might similarly offset his wagering losses against his wagering gains, but that each partner's share of wagering gains made in the partnership could not be reduced by wagering losses made individually.

We find nothing in the statute to support the last proposition. A partnership is recognized as an entity separate from the partners in bankruptcy proceedings, but not in income taxation. *United States* v. *Coulby*, 258 Fed. 27. For many years the Revenue Acts have provided that "*individuals* carrying on business in partnership shall be liable for income tax only in their *individual* capacity." Rev. Act of 1918, §218(a). 40 Stat. 1057, Revenue Act of 1936, §181, 49

Stat. 1648. Thereunder a tax on income earned in partnership was held not a claim against the partnership in bankruptcy, and it went unpaid for lack of individual assets. *United States* v. *Kaufman,* 267 U. S. 408 [1 USTC ¶116]. The partnership return is for information, and to secure uniformity and save repetition in the individual returns. It ascertains each partner's gain and apportions it to him to be taxed, whether distributed or not. It does not transform his share in the gain. If "individuals carrying on business in partnership," to use the phrase of the statute, make gains in wagering transactions, the share of each is a wagering gain; and when it is entered on his individual return to be taxed, a deduction of his losses in other wagering transactions is allowed by the statute, but only to the extent of such gains.

The Board followed especially the decision in *Johnston* v. *Commissioner,* 86 Fed. (2d) 732 [36-2 USTC ¶9547], which held a partner's losses by sale of noncapital assets could not be offset against a similar gain coming from his partnership, one judge dissenting. We are impressed that the dissenting judge was probably right, but that case dealt with a different statutory provision, and it had been amended by Congress, the purpose of the amendment being one of the disputed points. No amendment of the provision before us has been made, and its words seem plain enough.

The cause is remanded with direction to allow the deductions claimed and redetermine the taxes accordingly.

HOLMES, Circuit Judge, dissenting; The majority opinion holds that petitioners are entitled to offset personal losses from gambling operations against their distributive shares of partnership gains from similar operations. To concur in this ruling, it is necessary to conclude that, while Con-

gress provided for the separate computation of partnership income, it intended that the total so reached would be discarded and the individual items of gain or loss would then be separated and each brought forward into the returns of the respective partners, and there combined with individual income and deductions to arrive at the partners' net taxable income. The legislative intent, it seems to me, was just the opposite.

A defendant, in a suit against him for a debt due by him alone, may not offset a debt due to him and another, because the parties are different and there is a want of mutuality.[1] With this bed-rock principle in mind, the Congress undertook to regulate the method of accounting with a taxpayer as to income derived from the operations of a partnership. The firm, as an entity, is required to make a return but is not required to pay the tax. In this respect it has an advantage over a corporation.

Individuals carrying on business in partnership are liable for income tax only in their individual capacity. Each partner, in computing his net income, shall include in his individual return his distributive share, whether distributed or not, of the net income of the partnership for the taxable year. The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual. A partnership is not a taxable entity for income tax payment, but it is an entity for the purpose of computing the income upon which the partners individually are taxable.[2]

---

[1] 57 C. J., p. 454, Sec. 105, *et seq.*, *Mintz* v. *Tri-County Natural Gas Co.*, 259 Pa. 477, 103 A. 285; *Boehm* v. *U. S.*, 20 Ct. Cl. 142.

[2] Sections 23, 181, 182, and 183 of the Revenue Act of 1936, ch. 690, 49 Stat. 1648; *Johnston* v. *Commissioner*, 86 F. (2) 732 [36-2 USTC ¶9547], Cert. denied, 301 U. S. 683.

The inference is clear that Congress did not intend that income from a partnership should retain in the individual partner's return the same characteristics which it had in the partnership, except as specially provided in Sections 184, 185, and 186 of said Revenue Act of 1936, which special provisions negative any other exceptions.[3] The distributive share which the individual partner is required to include in his return may result from the computation of separate items of gain or loss, but is distinct from those items and has a separate identity. It is reported as a separate item in the partner's return just as the shareholder reports a corporate dividend. The complications of any other method of accounting are apparent.

An identical question of statutory construction was presented to the court in *Johnston* v. *Commissioner, supra,* the only difference being that this case involves Section 23(g), which relates to wagering losses, while the *Johnston* case involved Section 23(r), which limited the deduction of losses sustained on the sale of non-capital assets in relation to the gains from such sales. It is true, there was a dissent in that case, and the majority opinion here follows in principle the reasoning of that dissent, though this is a weaker case for the application of the principle, as a gambling partnership is not entitled to legislative encouragement as is a legitimate business. See also, to the same effect as the majority ruled in the *Johnston* case, *Klingenstein* v. *U. S.*, 18 Fed. Supp. 1015 [37-1 USTC ¶9255], Cert. denied, 302 U. S. 716.

In the Revenue Act of 1938, Section 182 was amended for the specific purpose of allowing the segregation of short-time gains or losses in the partnership return, and the retention of such status for use by the partner in his individual

---

[3] *Botany Mills* v. *United States,* 278 U. S. 282, 289 [1 USTC ¶348].

return. In its report, the committee noted that the proposed change involved a departure from the general rule.[4] Since no such change or departure from the general rule was made by the Congress with reference to the statute limiting the deduction of wagering losses, the reasonable conclusion is that there was no intention to depart from the general rule where gambling gains or losses resulted from partnership operations. While, as we have seen, some exceptions were expressly made with reference to partnership items retaining their original characteristics in the partners' individual returns, it is undisputed that no such exception was expressly made which involved gains or losses from gambling operations; and I think none should be implied.

---

[4] H. Rep. No. 1860, 75th Cong., 3rd Sess., pp. 42-43.

BLANK PAGE

pp. 3, 4, 5, 6,

SUPREME COURT OF THE UNITED STATES.

No. 5.—October Term, 1940.

Harry H. Neuberger, Petitioner,
vs.
Commissioner of Internal Revenue, Respondent.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[November 12, 1940.]

Mr. Justice Murphy delivered the opinion of the Court.

Petitioner, a resident of New York, was a member of the New York Stock Exchange. He was engaged in the business of trading in securities on the floor of the Exchange for the partnership of Hilson & Neuberger, of which he was a member, executing orders on behalf of customers of the partnership. In addition he made numerous purchases and sales of securities for his own account.

During the year 1932, the one here in question, Hilson & Neuberger derived a profit of $142,802.29 from the sale of securities which were not capital assets as defined in Section 101 of the Revenue Act of 1932. 47 Stat. 169, 191. The firm had other income of $170,830.65 and deductions of $203,981.78, or net income of $109,651.16. Petitioner's distributive share was $44,158.55. During the same year petitioner sustained a net loss of $25,588.93 on his private transactions in stocks and bonds which were not capital assets as defined in Section 101.

In his income tax return for the year 1932 petitioner deducted from gross income the loss of $25,588.93. The Commissioner disallowed the deduction and assessed a deficiency. The Board of Tax Appeals upheld the action of the Commissioner. 37 B. T. A. 223. On appeal the Second Circuit Court of Appeals affirmed. 104 F. (2d) 649. Because of substantial conflict with *Jennings* v. *Commissioner,* 110 F. (2d) 945, and *Craik* v. *United States,* 31 F. Supp. 132, we granted certiorari limited to the questions whether Section 23(r)(1) of the Revenue Act of 1932, 47 Stat. 169, 183, authorized the claimed deduction and whether, in the event that it

did not, the statute as so construed was constitutional. 310 U. S. 655.

Section 23 of the Revenue Act of 1932 sets out the allowable deductions from gross income. Section 23(r)(1) provides:

"Losses from sales or exchanges of stocks and bonds (as defined in subsection (t) of this section) which are not capital assets (as defined in section 101) shall be allowed [as deductions from gross income] only to the extent of the gains from such sales or exchanges. . . ."

The basic and narrow question is whether, in computing the income of an individual partner, the word "gains" in Section 23 (r)(1) includes gains from sales or exchanges of partnership stocks and bonds which are not capital assets as defined in Section 101. We are of opinion that it does.

In computing gross income prior to the Revenue Act of 1932, subject to certain limitations a taxpayer was entitled to deduct the full amount of his losses from transactions in securities. Revenue Act of 1928, §§ 23(e), 23(g), 101(b), 113. But the growing custom of diminishing ordinary income by deducting losses realized on the sale of securities which had shrunk in value, due no doubt to the fall in prices after 1929, led Congress to provide in Section 23(r)(1) that deductions for such losses should be limited to gains from similar transactions.

That this was the purpose and the only purpose of Section 23 (r)(1) abundantly appears from the Report of the Senate Finance Committee accompanying the bill.[1] Nowhere does there appear any intention to deny to a taxpayer who chooses to execute part of his security transactions in partnership with another the right to deductions which plainly would be available to him if he had exe-

[1] Report of Senate Finance Committee (72d Congress, 1st Sess.), Number 705, p. 10:

"Your committee believes that security gains and losses should be segregated, that security losses should be deducted solely from security gains; but that security gains should not be taxed until they actually exceed security losses."

See also Report of House Ways and Means Committee (72d Congress, 1st Sess.), Number 708, pp. 12-13:

"There are no provisions in existing law corresponding to section 23 (r). . . . Many taxpayers have been completely or partially eliminating from tax their income from salaries, dividends, rents, etc., by deducting therefrom losses sustained in the stock and bond markets, with serious effect upon the revenue. Your committee is of the opinion that some limitation ought to be placed on the allowance of such losses."

cuted all of them singly. Nowhere is there any suggestion that Congress intended to tax noncapital security gains until they exceeded similar losses. The language of Section 23(r)(1) does not require such a construction. Nor do the available evidences of Congressional intent indicate such a purpose.

Respondent points out, however, that under Sections 181-189 of the Revenue Act of 1932, 47 Stat. 169, 222-223,[2] partnership income is computed on an entity basis, that items of partnership gross income do not appear on a partner's return, that only partnership net income is reflected in the individual partner's income and is reported only in the form of a distributable or distributed share. He contends that since partnership income is computed in the same

47

---

2 Sec. 181. Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

Sec. 182. (a) There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year.

(b) . . .

Sec. 183. The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except that the so-called "charitable contribution" deduction provided in section 23(n) shall not be allowed.

Sec. 184. The partner shall, for the purpose of the normal tax, be allowed as a credit against his net income, in addition to the credits allowed to him under section 25, his proportionate share of such amounts of dividends and interest specified in section 25 (a) and (b) as are received by the partnership.

Sec. 185. In the case of the members of a partnership the proper part of each share of the net income which consists of earned income shall be determined under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary and shall be separately shown in the return of the partnership and shall be taxed to the member as provided in this Supplement.

Sec. 186. In the case of the members of a partnership the proper part of each share of the net income which consists, respectively, of ordinary net income, capital net gain, or capital net loss, shall be determined under the rules and regulations to be prescribed by the Commissioner with the approval of the Secretary, and shall be separately shown in the return of the partnership and shall be taxed to the member as provided in this Supplement, but at the rates and in the manner provided in section 101 (a) and (b), relating to capital net gains and losses.

Sec. 187. The benefit of the special deduction for net losses allowed by section 117 shall be allowed to the members of a partnership under regulations prescribed by the Commissioner with the approval of the Secretary.

Sec. 188. The amount of income, war-profits, and excess-profits taxes imposed by foreign countries or possessions of the United States shall be allowed as a credit against the tax of the member of a partnership to the extent provided in section 131.

Sec. 189. Every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this title, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.

way as an individual's the deduction afforded by Section 23(r)(1) to the partnership is a distinct privilege not to be confused or combined with that afforded to the individual. Thus, he argues, the deduction claimed here is inconsistent with the general scheme created for reporting partnership income as well as, in effect, a second or double use of Section 23(r)(1).

It is not to be doubted that in the enactment of Section 23(r)(1) Congress intended not only to deal with individual security gains and losses, but also to permit losses suffered in partnership security transactions to be applied against partnership gains in like transactions. It does not follow, however, and the language of the statute does not provide, either expressly or by necessary implication, that losses sustained in an individual capacity may not be set off against gains from identical though distinct partnership dealings. If the individual losses are actually incurred in similar transactions it cannot justly be said that the same deduction is taken a second time, or that the real purpose of the statute, which is ultimately to tax the net income of the individual partner, would thereby be impaired.

Sections 181-189 of the Revenue Act of 1932, 47 Stat. 169, 222-223, provide generally for computation and reporting of partnership income. In requiring a partnership informational return although only individual partners pay any tax, Congress recognized the partnership both as a business unit and as an association of individuals. This weakens rather than strengthens respondent's argument that the privileges are distinct or that the unit characteristics of the partnership must be emphasized. Compare *Jennings* v. *Commissioner,* 110 F. (2d) 945; *Craik* v. *United States,* 31 F. Supp. 132; *United States* v. *Coulby,* 251 Fed. 982 (affirmed, 258 Fed. 27). Nor is the deduction claimed here precluded because Congress, in Sections 184-188, has particularized instances where partnership income retains its identity in the individual partner's return. The maxim "expressio unius est exclusio alterius" is an aid to construction not a rule of law. It can never override clear and contrary evidences of Congressional intent. *United States* v. *Barnes,* 222 U. S. 513.

It is true that the Treasury Department adopted a contrary position and denied the claimed deduction. G. C. M. 14012, XIV-1 Cum. Bull. 145; I. T. 2892, XIV-1 Cum. Bull. 148. Under different circumstances great weight has been attached to administrative prac-

tice and treasury rulings, but beyond question they cannot narrow the scope of a statute when Congress plainly has intended otherwise. *Rasquin* v. *Humphreys*, 308 U. S. 54; *Norwegian Nitrogen Products Co.* v. *United States*, 288 U. S. 294.

It is true, too, that in some cases the characteristics of partnerships as business units have been emphasized, *Forres* v. *Commissioner*, 25 B. T. A. 154; *Wilson* v. *Commissioner*, 17 B. T. A. 976 (appeal dismissed, 55 F. (2d) 1086); *Burns* v. *Commissioner*, 12 B. T. A. 1209; *Appeal of Menken*, 8 B. T. A. 1062, while in others the characteristics of partnerships as associations of individuals have been stressed. *United States* v. *Coulby*, *supra*. Compare *Bence* v. *United States*, 18 F. Supp. 848. These cases, not decided under the Revenue Act of 1932 and turning, as they must, on their own peculiar facts, are little aid in ascertaining the effect to be given to Section 23(r)(1).

It is not true, however, as respondent argues, that the asserted deduction cannot be allowed because petitioner has suggested no way to calculate it properly or to import items of gross income from the partnership informational return. The Board of Tax Appeals expressly found the amount of partnership gains from security transactions and the proportion in which petitioner was to share in the profits of the partnership. 37 B. T. A. 223, 224. Since petitioner's share of these noncapital security gains is greater than his loss of $25,588.93, the limit on deductions set by Section 23(r)(1) is not exceeded.

Our conclusion that this is the proper construction of Section 23(r)(1) is confirmed by the action of Congress since 1932. In 1933 Congress amended Section 182(a) of the Revenue Act of 1932 to deny to individual partners deductions for partnership losses which had been disallowed in the partnership return, the converse of the instant case. 48 Stat. 195, 209.[3] More significantly, in 1938, after the Treasury Department had ruled to the contrary, G. C. M. 14012, XIV-1 Cum. Bull. 145; I. T. 2892, XIV-1 Cum. Bull. 148, Congress expressly provided for the deduction of individual security losses from similar partnership gains. Revenue

[3] In Senate Finance Committee Report Number 114 (73rd Congress, 1st Sess.) accompanying the bill, it is stated at page 7:

"Subsection (d) amends the partnership provisions of existing law. Under existing law the individual members of a partnership are entitled to reduce their individual net incomes by their distributive shares of a net loss incurred by the partnership."

That the amendment of 1933 changed and the Revenue Act of 1938 restored the law of 1932 as we have explained it is plain from the legislative history of the two Acts and of § 23 (r) (1).

Shearer v. *Burnet*, 285 U. S. 228, is not contrary to the conclusion we reach here. There the decision turned on the proper construction to be given to Section 218(a) of the Revenue Act of 1924, 43 Stat. 253, 275, and the court correctly concluded that Congress had not intended to allow the asserted credit.

We conclude that petitioner is entitled to the deduction. The decision of the Second Circuit Court of Appeals is reversed, and the case is remanded with directions to remand to the Board of Tax Appeals for proceedings in conformity with this opinion.

Reversed and Remanded.

Mr. Justice ROBERTS, Mr. Justice BLACK, and Mr. Justice DOUGLAS are of opinion that the judgment should be affirmed.

A true copy.

Test:

Clerk, Supreme Court, U. S.

---

[4] In House Ways and Means Committee Report Number 1860 (75th Congress, 3rd Sess.) accompanying the bill, it is stated at pages 42-43:

"The method of treatment provided in these sections of the bill is a logical corollary of the principle that only the partners as individuals, not the partnership as an entity, are taxable persons and is necessary to give the partners as individuals the benefit of the alternative tax in the case of net long-term capital gains, provided in section 117 (c), with respect to such gains realized upon the sale or exchange of partnership capital assets. It should be noted that this method involves a departure from the principle adopted in the Revenue Acts of 1934 and 1936. . . ."